

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

1	UNITED STATES OF AMERICA,)	
2	STATES OF ARIZONA, CONNECTICUT,)	
3	IDAHO, ILLINOIS, IOWA,)	
4	MARYLAND, MICHIGAN, MISSOURI,)	
5	MONTANA, NEBRASKA,)	10-CV-4496 (NGG)
6	NEW HAMPSHIRE, OHIO,)	
7	RHODE ISLAND, TENNESSEE,)	United States Courthouse
8	TEXAS, UTAH AND VERMONT,)	Brooklyn, New York
9)	
10	Plaintiffs,)	
11)	
12	-against-)	
13)	
14	AMERICAN EXPRESS COMPANY,)	WEDNESDAY, JULY 30, 2014
15	ET AL.,)	9:00 a.m.
16)	
17	Defendants.)	

REDACTED TRANSCRIPT OF CIVIL CAUSE FOR BENCH TRIAL
BEFORE THE HONORABLE NICHOLAS G. GARAUFIS
UNITED STATES DISTRICT JUDGE

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1 THE COURT: Please be seated.

2 THE CLERK: Case on trial. Counsel, please state
3 your appearances for the record.

4 MR. CONRATH: Craig Conrath for the United States.

5 THE COURT: Good morning.

6 MR. CONRATH: Good morning, Your Honor.

7 MR. GENTILE: Mitch Gentile for the plaintiff
8 states. Good morning, Your Honor.

9 THE COURT: Good morning, sir.

10 MR. CHESLER: Good morning, Your Honor, Evan Chesler
11 for American Express.

12 THE COURT: Good morning.

13 MR. FLEXNER: Good morning, Your Honor, Donald
14 Flexner for American Express.

15 THE COURT: Good morning.

16 All right. We're on cross-examination. Anything
17 before we start?

18 MR. CONRATH: Nothing from us, Your Honor.

19 THE COURT: Okay. Let's bring the witness please.

20 (Witness enters courtroom and resumes the stand.)

21 THE COURT: Good morning, sir. Please be seated.

22 THE WITNESS: Thank you.

23 THE COURT: I remind the witness that he is still
24 under oath.

25 You may continue your cross-examination,

1 Mr. Chesler.

2 MR. CHESLER: Thank you, Your Honor.

3 Your Honor, by way of housekeeping, there are two
4 documents that I used yesterday with the witness which I'd
5 like to offer only for demonstrative purposes. They had
6 numbers on them which I did not read aloud because of
7 confidentiality and, therefore, in order to be clear on the
8 record what numbers the witness and we were all looking at, I
9 think we need to offer those two documents and one of them I'm
10 going to offer in in an amended form for a reason I'll explain
11 in a moment but the two numbers are DX 7760A, I used 7760
12 yesterday and I'll explain the difference of the A version,
13 and 7761 for illustrative purposes only.

14 THE COURT: I had written down 7760, that's your
15 witness' rebuttal report.

16 MR. CHESLER: Yes, the three pie chart.

17 THE COURT: The demonstrative, the pie charts.

18 MR. CHESLER: Yes.

19 THE COURT: It's a demonstrative, I'm sure we'll
20 hear from Dr. Bernheim about it.

21 MR. CONRATH: I think so, Your Honor. So, as to
22 7761, I have no objection; as to 7760A, I guess I should wait
23 to hear what the difference is before I comment.

24 THE COURT: Yes.

25 MR. CHESLER: Let me give a copy of that to counsel.

1 May I hand up a copy?

2 THE COURT: Yes, of course. 7761 is received in
3 evidence without objection.

4 (Defendant's Exhibit 7761 so marked in evidence.)

5 THE COURT: And the difference is in 7760?

6 MR. CHESLER: In the text below the middle and the
7 right-hand pie charts, Your Honor, in 7760 there was an error,
8 they both said more secure, more secure rather than more
9 accepted, more convenient, so it was just a typo, they should
10 have said the same thing as the words at the top of each pie
11 chart. The first bullet under each pie chart said secure in
12 all three cases. That was a mistake, it should have said
13 accepted in the middle one and convenience in the right-hand
14 one, so we just corrected those two words.

15 THE COURT: Does that bear any relationship to the
16 testimony of the witness?

17 MR. CHESLER: No, the witness was actually looking
18 and I directed him to the words on the top of the pie charts
19 which were in that exhibit just as they are in this one, they
20 haven't changed. The typo was in the first bullet below each
21 pie chart.

22 THE COURT: Let me show the witness the changes.

23 THE WITNESS: Your Honor, I was reading across the
24 top, I understood it to be three different pie charts.

25 THE COURT: Okay. Then is there an objection to it

1 serving as a demo exhibit?

2 MR. CONRATH: As a demonstrative, no, Your Honor.
3 We'll take a look at the correction. I guess I reserve any
4 right if we look at the correction and find there's some
5 problem with it but I don't have an objection as to the
6 demonstrative.

7 THE COURT: All right, that's fine.

8 Please be seated, sir.

9 All right. DX 7760A is received in evidence as a
10 demonstrative.

11 MR. CHESLER: Thank you, Your Honor.

12 (Defendant's Exhibit 7760 so marked in evidence.)

13 M I C H A E L K A T Z, having been previously
14 duly sworn was examined and testified as follows:

15 CROSS-EXAMINATION (Cont'd.)

16 BY MR. CHESLER:

17 Q Good morning, Dr. Katz.

18 A Good morning.

19 Q Dr. Katz, would you agree that it is necessary to know
20 what products are at issue in order to assess whether there is
21 more or less competition among those products?

22 A Yes.

23 Q And so, in order to properly evaluate the competitive
24 effect of a vertical restraint, do you agree that the market
25 in which that vertical restraint exists has to be properly

Katz - cross - Chesler

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1 defined?

2 A No, I don't fully agree with that. I certainly am in
3 favor of proper market definition and think an improper one
4 could mislead you but it's well known that among economists
5 there are numerous ways to analyze the effects of something
6 without having to formally define a relevant market. That's
7 an opinion that I hold and share actually with at least some
8 of your own experts.

9 Q Okay. But you, in any event, agree I think you said that
10 in order to determine whether there's more or less competition
11 among a group of products, you need to be sure you've
12 identified which products you have in mind, correct?

13 A Yes.

14 Q Now, do you agree that if a firm does not possess
15 significant market power in a relevant market, one is unlikely
16 to be concerned with the effects of its behavior on
17 competition?

18 A Yes, as a general matter that's right, one is unlikely.
19 There are exceptions but I agree with that statement, I
20 believe I've made it in my report.

21 Q Do you also agree that in this two-sided market a firm
22 could even have the power to set price above a competitive
23 level based, for example, on insistence and yet at the same
24 time lack sufficient market power to engage in
25 anti-competitive conduct?

Katz - cross - Chesler

4119

1 A So, it would depend on the conduct but there could be
2 situations where that's true, yes.

3 Q And, in fact, you believe, do you not, that the ability
4 to set prices greater than at a competitive level is not
5 equivalent to the ability to harm competition more broadly
6 through many vertical restraints such as the
7 non-discrimination provisions?

8 A That's right, by itself it does not imply that.

9 Q And, in particular, you believe that market shares play
10 an important role in a firm's ability to impose vertical
11 restrictions that harm competition?

12 A Certainly they can and I believe in this market they do
13 play that role.

14 Q Now, in the U.S. v. Visa case you concluded that Visa and
15 MasterCard had substantial market power, correct?

16 A In the relevant markets in that case, yes.

17 Q And you also concluded that competition from American
18 Express was limited in the market for credit and charge card
19 network services, correct?

20 A Yes.

21 Q And you also in that case testified that the high
22 combined market share of Visa and MasterCard went hand-in-hand
23 with low market shares for American Express and Discover,
24 isn't that true?

25 A Yes. That's an accounting identity since the shares have

Katz - cross - Chesler

4120

1 to add up to 100.

2 Q So, in the U.S. v. Visa case you actually characterized
3 American Express's market share as low, didn't you?

4 A I don't recall. I certainly characterized it as lower
5 than their shares and lower than I thought it would be absent
6 the exclusionary rules.

7 Q Well, let me ask you to look at Defendant's Exhibit 733
8 which is in volume one, that's your direct testimony from the
9 Visa case, and in particular paragraph 169 which begins on
10 page 89.

11 A I'm sorry, I must be looking at the wrong exhibit. What
12 number?

13 Q The exhibit is DX 733, page is page 89 from the excerpt
14 that appears behind that tab and in particular paragraph 169.

15 Do you have that, sir?

16 A Yes, I do.

17 Q And you see that in the first sentence of paragraph 169
18 of your direct testimony you said:

19 "A second reason why market shares are informative
20 follows from the fact that the large combined market share of
21 the associations --

22 That was Visa and MasterCard, right?

23 A Yes.

24 Q -- goes hand-in-hand with the low market shares of
25 American Express and Discover/Novus."

Katz - cross - Chesler

4121

1 Do you see that, sir?

2 A Yes, I do.

3 Q So, did you characterize American Express's market share
4 in that case as low?

5 A Yes, and I think if you look in context though in the
6 next sentence that I'm saying that the shares of the two
7 associations were high and by that I mean the other ones are
8 low being the opposite of it and as you see in the second
9 sentence, I'm saying the relatively low shares. I certainly
10 believed then and believe now that their shares were lower and
11 significantly lower than the combined shares.

12 MR. CHESLER: Your Honor, my efficient staff has
13 told me we have to turn on our feed on our side of the
14 courtroom.

15 THE COURT: Thank you.

16 Q Do you recall that at the time that you so characterized
17 the American Express share that it was about 20 percent of
18 spend volume?

19 A That's my recollection but I'd have to check but that's
20 my recollection.

21 Q You also testified, did you not, that the relatively low
22 market share that American Express had reflected the fact that
23 it would likely have difficulty taking business away from
24 MasterCard and Visa if those networks were to reduce the
25 attractiveness of their offerings by raising prices, lowering

Katz - cross - Chesler

4122

1 product and service quality or reducing their level of
2 innovation, do you recall testifying to that?

3 A I don't recall saying that specifically except as part of
4 reading the paragraph I saw, I did in fact say that.

5 Q You did in fact say that. Thank you.

6 You also said that it was your belief that American
7 Express could take actions to increase the size of its'
8 acceptance network including by lowering its price but that
9 American Express did not do so because it thought that doing
10 so would not be a profitable strategy and that the costs of
11 doing so would outweigh the benefits, do you recall testifying
12 to that, sir?

13 A I don't recall testifying to that in that case but that
14 certainly -- wait a minute, not supports, that certainly
15 reports economic logic that I would support so I would not be
16 at all surprised that I said it.

17 Q Let me ask you to look at Defendant's Exhibit 708 please.
18 This is also in volume one. These are excerpts from your
19 testimony in the U.S. v. Visa case and -- I'm sorry, this is
20 actually from your deposition in that case. I'd like you to
21 turn to page 380 of the transcript.

22 A I'm there.

23 Q I'm sorry, I've taken you to the wrong page. Page 150.

24 Page 150 of Defendant's Exhibit 708, do you have
25 that?

Katz - cross - Chesler

4123

1 A Yes, I do.

2 Q Now, beginning -- these pages for some reason are not
3 numbered, the lines are not numbered but about three or four
4 questions down into the page there's a question that begins
5 "Prior to 1995," do you have that one?

6 A Yes, I do.

7 Q The question was: "Prior to 1995 could American Express
8 have taken actions that would have increased the size of their
9 network such as lowering the merchant discount rate, for
10 example?"

11 Your answer was: "Yeah, I believe the actions they
12 could have that they might be able to increase the size of the
13 merchant acceptance network."

14 Then you were asked:

15 "Question: And do you know why they didn't?

16 "Answer: My belief would be that they thought
17 that doing so would not be a profitable strategy and that the
18 cost of doing it would outweigh the benefits."

19 So far do you agree with the testimony that you gave
20 there, sir?

21 A Yes.

22 Q Now, you were then asked in the very next question:

23 "Does that imply anything about whether or not
24 American Express has market power?" That being the strategy
25 that you just described, correct?

Katz - cross - Chesler

4124

1 A Yes.

2 Q And your answer was:

3 "Answer: I don't see how the fact that they found
4 their actions, the fact that there were actions that they
5 might have taken that they didn't but would have been
6 unprofitable, as I sit here I don't see how that is indicative
7 of having market power."

8 Do you stand by that testimony, sir?

9 A I stand by the testimony I gave there based on the
10 general statement about the fact that it was unprofitable to
11 lower the price to increase the acceptance network. My
12 testimony in this case is based on information that goes
13 beyond that. I'm not relying just on the fact that it was
14 unprofitable, I'm relying on the fact it was unprofitable even
15 though they were getting positive contribution margins from
16 merchants. This is a statement about a broader logic. So, I
17 agree with the statement I made there and I believe it is
18 fully consistent with what I've done in this case.

19 Q All right. We'll probe that a bit further in a few
20 minutes.

21 THE COURT: Oh, I don't seem to have that page in my
22 book so that's all right, I've got it on the screen but I
23 would just like to have it for my record.

24 MR. CHESLER: We will provide that, Your Honor, I'm
25 sorry.

1 THE COURT: Thank you.

2 Q Now, you also testified in the Visa case that the size
3 and coverage of a systems acceptance network is one of the
4 most important characteristics of a credit and charge card
5 system, didn't you?

6 A I believe I did, yes.

7 Q And that a system with limited acceptance is of limited
8 value to potential cardholders because of the network effect,
9 correct?

10 A That's correct.

11 Q And do you recall that you relied in that case on
12 statements from American Express executives that the smaller
13 size of their acceptance network relative to Visa and
14 MasterCard was a source of competitive disadvantage to
15 American Express, do you recall doing that, sir?

16 A I don't recall doing that but it is certainly plausible
17 that I would have done that.

18 Q Let's look at 733 again which is your direct testimony
19 and at page 213, footnote 542 on 213, you say:

20 "American Express executives indicated that the
21 smaller size of the American Express acceptance network
22 relative to those of MasterCard and Visa continues to be a
23 significant source of competitive disadvantage in attracting
24 consumer cardholders?"

25 So, do you see that you in fact refer to that and

Katz - cross - Chesler

4126

1 that's consistent with your recollection, sir?

2 A As I say, I don't recollect it but I'm not at all
3 surprised I said it and I certainly agree I said it.

4 Q Now, are you aware that the evidence in this case
5 indicates that Discover has many more accepting merchants than
6 American Express does?

7 A You're saying the present case?

8 Q Yes, sir?

9 A Yes.

10 Q In fact, the locations in force, according to industry
11 sources, are something like three million more for Discover
12 than American Express?

13 A That sounds about right. I more have the visual in my
14 mind but yes.

15 Q And are you aware that Mr. Hochschild of Discover
16 testified in this case that Discover's coverage gap even with
17 that many merchants, this is coverage gap as compared to Visa
18 and MasterCard, is a competitive weakness of Discover?

19 A No, I don't recall seeing that testimony.

20 Q Back in the Visa case you testified, did you not, that
21 executives from Visa and MasterCard had identified the fact
22 that American Express had a smaller acceptance network as a
23 significant source of competitive disadvantage for American
24 Express in competing against the larger networks?

25 A Again I don't recall but it sounds plausible.

Katz - cross - Chesler

4127

1 Q Just so we're clear in the record, if you'd look at
2 paragraph 69 of your Visa testimony which is Exhibit 733, it
3 is at page 33, you see the last sentence on page 33 carrying
4 over to 34, you say: "MasterCard and Visa executives have
5 identified the fact that American Express has a smaller
6 acceptance network than either of the two associations as a
7 significant source of competitive disadvantage for American
8 Express."

9 Do you see that?

10 A Yes, I do.

11 Q And American Express still has a significant coverage gap
12 as compared to Visa and MasterCard, correct?

13 A Certainly measured in terms of the number of merchants it
14 is, you'd have to go back and look at the composition of the
15 merchants who weren't covered then and there to say if it is
16 the same gap but yes, there are millions of merchants they
17 don't take even though they are a small percentage of charge.

18 Q Are you aware of the testimony in this record that the
19 merchants that American Express does not have acceptance at
20 are merchants that are largely in the range of half a million
21 dollars or less of charge volume, are you aware of that
22 testimony, sir?

23 A I've seen -- I don't recall the testimony. I've seen
24 various documents talking about them being small but I don't
25 have a particular threshold in mind.

Katz - cross - Chesler

4128

1 Q Are you aware of the testimony that that same size, half
2 a million dollars or less of charge volume, is in fact the
3 size of approximately 98 percent of American Express's current
4 merchants?

5 A I wouldn't be surprised. My understanding is that most
6 of the current merchants are in fact small merchants if you're
7 just counting them, yes.

8 MR. CONRATH: Your Honor, I believe this document is
9 labeled as filed under seal in the prior case and I don't know
10 if that's ever been restricted and I don't think anything
11 that's been discussed here is significant but we probably
12 should honor that prior sealing since we haven't done anything
13 to remove it.

14 MR. CHESLER: I agree, Your Honor. I've stayed away
15 from anything that we thought was and I'm not going to go any
16 further into the content on the record.

17 THE COURT: All right.

18 Q Now, in your direct testimony yesterday you testified
19 that American Express was able to profitably increase its
20 rates to merchants through its value recapture initiative, do
21 you recall that?

22 A Yes, I do.

23 Q And you cited that in the context of your discussion of
24 market power?

25 A Yes.

Katz - cross - Chesler

4129

1 Q Now, you agree, do you not, that a price increase alone
2 does not demonstrate the existence of antitrust market power?

3 A Yes, I do.

4 Q And are you aware, sir, that during the period of
5 American Express's value recapture effort Discover raised its
6 prices in a number of industry segments including travel and
7 entertainment?

8 A That's my recollection, yes.

9 Q And I'd like you to look at Defendant's Exhibit 6466
10 which is in the first volume, this is your first report in
11 this case, and I'd like you to look at, if I can get there,
12 page 288 which is one of the diagrams, it is actually
13 Figure VI.

14 So, we're in Defendant's Exhibit 6466, which is your
15 first report in this case, Figure VI which appears at page
16 288, do you have that?

17 A Yes, I do.

18 Q Now, the blue line in the middle on this chart is your
19 effort to depict American Express's average effective discount
20 rate between 2001 and 2011. This is for -- that line is for
21 the combined travel and entertainment and the rest of the
22 market combined, correct?

23 A That's correct.

24 Q So, according to your compilation of the data, during
25 that ten year period American Express's average effective

Katz - cross - Chesler

4130

1 discount rate declined, correct?

2 A Yes.

3 Q And that includes the period of time during which the
4 value recapture initiative took place, correct?

5 A That's correct.

6 Q Now, as you presented it in your report, if I understand
7 this correctly, the effective discount rate reflects money
8 that the merchant pays to American Express such as the
9 discount fee and other fees associated with transactions such
10 as a card not present fee, correct?

11 A I believe that's right that that's calculated in the
12 discount revenue actuals, yes.

13 Q And it also reflects money that American Express pays to
14 the merchant, some money such as signing bonuses and marketing
15 funds that are not actually used for marketing, right?

16 A That's right, my recollection is it has contra revenues.

17 Q You netted those out and that number was used to
18 calculate your effective discount rate as depicted on
19 Figure VI, correct?

20 A I believe so, yes.

21 Q Now, there were certain categories of payments that
22 American Express makes to merchants that are not included in
23 your calculation of the net effective discount rate, correct?

24 A That is correct.

25 Q So, for example, payments that American Express makes to

Katz - cross - Chesler

4131

1 merchants in connection with co-brand deals were not factored
2 into your calculation, correct?

3 A Let's be clear, you are talking about payments that were
4 made to a merchant that was a co-brand partner in its role as
5 being a co-brand partner, those were not included, that's
6 correct.

7 Q So, for example, you're aware that American Express, I
8 won't mention the amount, but American Express paid to Delta
9 Airlines a signing bonus as part of its 2008 co-brand
10 agreement of a significant amount of money that's not included
11 in your calculation of American Express's net discount rate,
12 correct?

13 A That's correct.

14 Q And the same is true of the signing bonus that American
15 Express paid to JetBlue, which again I won't mention on the
16 record, you didn't include that in your calculations either,
17 did you?

18 A As a signing bonus for co-brand, it would not be
19 included.

20 Q Now, are you also aware that in 2008 American Express
21 pre-purchased, and I can state this number because it's
22 been publicly reported by the merchant, American Express
23 pre-purchased a billion dollars worth of Delta SkyMiles, do
24 you recall that?

25 A I remember they did a big pre-purchase and that number

Katz - cross - Chesler

4132

1 sounds familiar.

2 Q And so, in 2008 which was part of what you described
3 yesterday as the Great Recession, right?

4 A Yes.

5 Q So, in the midst or early on in the Great Recession
6 American Express gave Delta a billion dollars interest free as
7 a pre-purchase of SkyMiles, correct?

8 A That's correct.

9 Q And you did not, for example, factor in the value of
10 Delta having not the billion dollars itself but the value of
11 having a billion dollars of cash in its hands, for example,
12 the interest value, the carrying value of that money, you did
13 not include that in your calculation of the net discount rate
14 to merchants during that period, did you?

15 A That's correct.

16 Q Now, I'd like you to look at Defendant's Exhibit 6540
17 please which is another one of your reports in this case and I
18 want you to look at page 430 of that document.

19 Now, this is a table which is labeled Table VI G-1,
20 correct?

21 A Yes.

22 Q And it is entitled: American Express's Overall Economic
23 Price of Payment Services and Net Discount Rate Components of
24 Dr. Bernheim's Figure 2 and Figure 5 Calculations All
25 Merchants; did I read that correctly?

Katz - cross - Chesler

4133

1 A I believe you did.

2 Q All right. Would you agree with me, sir, that the
3 forgone interest value on the billion dollars of pre-purchased
4 SkyMiles by itself would reduce the American Express net
5 interest rate, net discount rate, excuse me, to all merchants
6 by the number of basis points that appears on the third line
7 up from the bottom of this chart on the right-hand column, the
8 last column on the right under 2010, the line is entitled
9 Forgone Interest?

10 A I'm looking at the line -- sorry, I just have to look,
11 there are a lot of tables, I want to make sure I understand my
12 own table, but I believe that's what this is showing.

13 Q And also if you included the co-brand remunerations which
14 you did not include, the effect on American Express's net
15 discount rate for all merchants in 2010 would be the number of
16 basis points that appears on the line right above that,
17 correct?

18 A Yes.

19 Q Now, would you look at the next page, page 431, this is a
20 similar table but this relates just to travel and
21 entertainment merchants, correct?

22 A Yes.

23 Q This one is labeled Table VI G-2.

24 Now, again, would you agree that the forgone
25 interest on the SkyMiles deal had you included it in your

Katz - cross - Chesler

4134

1 calculation of American Express's net discount rate would have
2 in 2010 represented the number of basis points that appears in
3 the 2010 column toward the bottom on the line labeled Forgone
4 Interest?

5 A Actually to be clear, so the record is clear, these are
6 expressed as percentages but, yes, they do imply basis points
7 but the units here are not basis points but other than that I
8 agree, yes.

9 Q Okay. And again, if you had included co-brand
10 remuneration in your calculation, then the effect of that on
11 lowering American Express's net effective discount rate for
12 2010 would be the number of basis points that appears on the
13 co-brand remuneration line, this is for travel and
14 entertainment merchants in 2010, correct?

15 A Yes.

16 MR. CHESLER: Your Honor, for illustrative purposes
17 I would like to offer those two charts, pages 430 and 431 of
18 Defendant's Exhibit 6540, we'll submit them separately, as
19 6540 A and B, if that's acceptable.

20 MR. CONRATH: As demonstratives I have no objection,
21 Your Honor.

22 THE COURT: All right. You'll mark them and submit
23 them as 6540 A and B. They're admitted in evidence as
24 demonstrative exhibits.

25 MR. CHESLER: Thank you, Your Honor.

Katz - cross - Chesler

4135

1 (Defendant's Exhibits 6540 A and B so marked in
2 evidence.)

3 Q Now, you did not include those items in your calculation
4 because in your view co-brand relationships are separate from
5 the acceptance relationship, correct?

6 A Yes. So, if you were to impute all of it, for example,
7 to the Delta relationship, my recollection is that the sort of
8 calculation Dr. Bernheim did would imply that American Express
9 was paying Delta to accept American Express at a negative
10 discount rate and I think that's an implausible result and I
11 think it is because, as you're saying, that the co-brand
12 relationship is a card issuing relationship and is something
13 different than a merchant acceptance relationship.

14 Q When you came to that conclusion, sir, did you consider
15 the evidence presented by Mr. Berry of American Express, by
16 internal American Express e-mails about the Starwood co-brand
17 relationship, the testimony of Mr. Brennan from Hilton Hotels,
18 the deposition testimony of Mr. Phillips from Delta, all
19 concerning the relationship between their co-brand agreements
20 and their acceptance agreements with American Express?

21 A I mean I considered different people. Those -- I don't
22 recall the specific names as I sit here but certainly there
23 was a set of people I considered including American Express
24 executives testifying that they tried to keep the two
25 negotiations separate.

Katz - cross - Chesler

4136

1 Q Let me ask you to look at Defendant's Exhibit 5817 which
2 is in the other volume.

3 I'm not going to mention the numbers here because
4 they're deemed confidential by Delta. Do you see that this
5 appears to be a memorandum or a document from Chris Phillips
6 to someone named Wayne Aaron and with copies to others
7 entitled American Express Rate Update from July 14th 2011?

8 A I see that, yes.

9 Q And you see that the document lists American Express
10 merchant rate across all card types and there's a number next
11 to it and then it says American Express merchant rate across
12 all card types after remuneration credit, do you see that?

13 A Yes.

14 Q And then it says SkyMiles co-brand card merchant rate if
15 remuneration is only applied to this subset of American
16 Express cards, and there's another rate, correct?

17 A Yes.

18 Q Did you consider this document from Delta in connection
19 with your decision not to include co-brand consideration in
20 your calculation of American Express's net discount rate?

21 A I don't recall having seen this document so I might have
22 but as I sit here, I don't recall incorporating it.

23 Q All right. I'd like you to look at Defendant's Exhibit
24 7775. This is an excerpt from the deposition of Mr. Phillips,
25 the author of that document. Do you have it, sir?

Katz - cross - Chesler

4137

1 A Yes, I do.

2 Q And I'd like you to look at, beginning at page 72 of the
3 transcript, and you see he's asked -- he's talking about this
4 document and he's asked at line 15:

5 "Okay. So, what you're doing here is you're trying
6 to figure out what the effective rate is considering various
7 other benefits that American Express provides to Delta?

8 "Answer: That is correct."

9 Do you see that?

10 A Yes.

11 Q Okay. I'd like you then to turn to page 82 of his
12 deposition transcript. At the very bottom of the page, line
13 22, it says:

14 "If you could please refer to Defendant's Exhibit
15 809. So, American Express's counsel -- this is Mr. Glass
16 questioning him -- American Express's counsel directed you to
17 the sentence that reads: AX merchant rate across all card
18 types after remuneration credit --" and then there's a
19 percentage number, correct?

20 A Yes.

21 Q The witness says, "Yes."

22 Then he's asked:

23 "Question: What's the remuneration credit?

24 "Answer: That's the number of basis points that
25 Delta receives for spend on all Delta co-brand credit cards."

Katz - cross - Chesler

4138

1 Do you see that, sir?

2 A Yes, I do.

3 Q He's plainly keeping track of calculating his overall
4 effective rate including the benefits that Delta was receiving
5 from the co-brand card, wasn't he?

6 A He's certainly doing some sort of calculation. From
7 looking at the page you have earlier it doesn't appear it's
8 the same set of calculations that Dr. Bernheim was suggesting
9 should be done because I believe the number is much higher, so
10 I don't know exactly what calculation Delta was doing but he
11 certainly says here, the plain English, that they were making
12 some adjustment for remuneration credit.

13 Q Did you review this, did you take this into consideration
14 when you decided to keep the co-brand consideration out of
15 your calculation?

16 A As I sit here, I don't know if I did or not. I don't
17 recall reading this text before.

18 Q Is it at all relevant to you in making this determination
19 that Mr. Brennan of Hilton Hotels testified here at trial, he
20 was asked: "And as I think you said in response to questions
21 from Mr. Read, therefore you leveraged that co-brand
22 relationship that American Express valued when you were
23 negotiating the terms of the card acceptance agreement,
24 correct?

25 "Answer: Yes, we brought that up relatively early

Katz - cross - Chesler

4139

1 in the negotiations."

2 Is that relevant to you in your consideration of
3 whether to keep co-brand remuneration and discount rate
4 separate?

5 A That statement, no.

6 Q Okay.

7 MR. CONRATH: Your Honor, just for the rule of
8 completeness, I'd like to read the next couple of questions
9 that Mr. Phillips -- and answers that Mr. Phillips had in the
10 examination by Mr. Glass.

11 MR. CHESLER: How far would you like me to read,
12 counsel?

13 THE COURT: I'd like to know page number of the
14 transcript.

15 MR. CHESLER: Yes, sir, I believe we're looking at
16 Defendant's Exhibit 7775 was the testimony of Mr. Phillips
17 that counsel is referring to.

18 MR. CONRATH: Correct.

19 MR. CHESLER: And I was reading from the top of page
20 83 a few minutes ago with the witness.

21 THE COURT: Yes, but I thought you were -- what were
22 you reading from just now?

23 MR. CHESLER: I was reading just now --

24 THE COURT: From the transcript of this trial, yes?

25 MR. CHESLER: Yes, sir.

Katz - cross - Chesler

4140

1 THE COURT: Is that what you're talking about?

2 MR. CONRATH: No, I'm talking about Mr. Phillips.

3 THE COURT: Oh, all right. I would like to know
4 where in the transcript of this trial you read from just for
5 completeness of the record.

6 MR. CHESLER: Yes, Your Honor, I was reading from
7 transcript page 1628 beginning at line 22.

8 THE COURT: Okay. Thank you. All right.

9 And as to Mr. Phillips's deposition, what are you
10 going to add?

11 MR. CONRATH: We're on page 83 and I'd like to begin
12 reading at line eight.

13 MR. CHESLER: Until where?

14 MR. CONRATH: Until 84, line 11.

15 MR. CHESLER: Okay.

16 "Question: Would Delta have received the
17 remuneration credit from American Express if it chose a
18 different co-brand partner?

19 "Answer: We -- there's an objection -- we would
20 not receive that from American Express, no.

21 "Question: So, if Delta chose a co-brand partner
22 other than American Express, its merchant rate discount rate
23 would be blank percent -- objection.

24 "The Witness: It would be blank percent.

25 "Question: So, the [REDACTED] basis point remuneration

Katz - cross - Chesler

4141

1 credit directly relates to whether or not American Express won
2 the co-brand relationship with Delta?

3 "Answer: No.

4 "Question: Why not?

5 "Answer: Many factors went into determining which
6 co-brand partner we went into and the remuneration was just
7 part of it.

8 "Question: Okay. I'll just rephrase that.

9 So, had American Express lost the co-brand
10 partnership, Delta would not have received the [REDACTED] basis
11 point remuneration credit on the discount rate?

12 There's an objection.

13 "Answer: I believe that's correct."

14 THE COURT: All right, thank you.

15 MR. CONRATH: Thank you. And we'd probably have to
16 go out and edit that number, there was a number that I think
17 you didn't intend that --

18 THE COURT: About the basis points?

19 MR. CONRATH: Yes, we'll check it on the transcript.

20 THE COURT: The number of basis points.

21 MR. CHESLER: I don't think that's confidential. It
22 was the numbers that led to that number that were confidential
23 and I did not recite those I believe.

24 THE COURT: The percentages you believe.

25 MR. CHESLER: Correct.

Katz - cross - Chesler

4142

1 THE COURT: Yes, I understand.

2 Q Now, Dr. Katz, would you go back to 6540, Defendant's
3 6540 which is one of your reports in this case. We were
4 looking at that a little while ago. I think it is your third
5 report and --

6 A I apologize. This is volume one?

7 THE COURT: One.

8 Q Yes, sir.

9 THE COURT: Volume one.

10 Q And in that document 6540, page 389. Do you have that,
11 sir?

12 A Yes.

13 Q This is Figure VI G-1 of your third report, correct?

14 A Yes.

15 Q Now, the orange, I guess it is orange sort of thick
16 dotted line across the top, that is your calculation of the
17 American Express net discount rate, correct?

18 A I think so. In any case, it's the net discount rate
19 based on the GMAPS system and how it assigns things which I
20 believe is what I was using.

21 Q Thank you. And the purple line that runs close to it but
22 not identical to it, that's Dr. Bernheim's calculation of the
23 net discount rate, correct?

24 A Yes.

25 Q And then down below the two -- the dotted and solid lines

Katz - cross - Chesler

4143

1 lower down on the chart, those are -- the red dotted line is
2 your so-called economic price based upon the GMAPS data,
3 correct?

4 A I believe it is actually Professor Bernheim assigning
5 names, his -- what he called the economic price but it is
6 using his concept that's based on GMAPS components only.

7 Q And his calculation of that economic price is the solid
8 blue line that runs close to that dotted line, correct?

9 A That's right. He made some adjustments that were
10 different -- well, adjustments to GMAPS.

11 Q All right.

12 Now, if you take the top two lines, yours and
13 Dr. Bernheim's on the top, the net discount rate
14 calculations you did, Dr. Bernheim's shows a decrease
15 from 2002 to 2010 of 11 basis points, correct?

16 A I'm sorry, taking the top line -- yes.

17 Q And yours shows a net decrease of two basis points,
18 correct?

19 A That's correct.

20 Q And the difference between those two slopes, a decrease
21 of 11 basis points versus a decrease of two is based upon
22 whether you include or exclude these additional items, forgone
23 interest and co-brand remuneration that we've been talking
24 about, correct?

25 A I'd have to check if those were the specific adjustments

Katz - cross - Chesler

4144

1 to which this table refers but if that's what you represent, I
2 have no reason to doubt it.

3 Q Okay. Thank you. I do.

4 Now, if you look at the next page of your report,
5 page 390 of Defendant's Exhibit 6540, this is a similar chart
6 but this one relates to travel and entertainment merchants
7 only, correct?

8 A That is correct.

9 Q And, again, if you look at your calculation of the net
10 discount rate which is the sort of thick orange dotted line
11 across the top, you show an increase from 2002 to 2010 of 20
12 basis points, correct?

13 A Yes.

14 Q And for that same period of time Dr. Bernheim, including
15 the adjustments that you did not include, shows a decrease of
16 nine basis points during that same period of time, correct?

17 A That is correct.

18 Q And that's within the T&E segment, correct?

19 A Yes.

20 Q And if you looked at the so-called economic rates that
21 are lower down on that chart, Dr. Bernheim would show a
22 decrease of over 50 basis points, right?

23 A Yes.

24 Q And you show a decrease of about half of that, correct?

25 A When you say I show, I mean it's a particular calculation

Katz - cross - Chesler

4145

1 I did but yes, that calculation shows a smaller decrease.

2 Q About half of the amount of basis point decrease as
3 Dr. Bernheim showed, correct?

4 A Yes.

5 MR. CHESLER: Your Honor, I would like to offer
6 these two charts, and we'll supply them separately to the
7 Court, as 6540 A and B for illustrative purposes only so as to
8 clarify the witness' testimony since we're not reciting all
9 the numbers on the record.

10 MR. CONRATH: I think those particular numbers have
11 already been used, they might have to be C and D.

12 THE COURT: Yes, A and B --

13 MR. CHESLER: Sorry.

14 THE COURT: A and B are taken.

15 MR. CHESLER: I'm sorry, Your Honor, counsel and are
16 you are absolutely right. We'll make them C and D then.

17 THE COURT: C and D are not taken. Now they are
18 taken.

19 MR. CONRATH: But as demonstratives, I do not
20 object.

21 THE COURT: Yes, as demonstrative exhibits they're
22 received in evidence, 6540 C is Figure VL G-1 and D is VL G-2.

23 (Defendant's Exhibits 6540 C and D so marked in
24 evidence.)

25 MR. CHESLER: Thank you very much, Your Honor.

Katz - cross - Chesler

4146

1 THE COURT: Thank you very much. Okay.

2 Q Now, on this value recapture issue, your position is that
3 value recapture shows that it is profitable for American
4 Express to raise the sum of its prices to merchants and
5 cardholders above the competitive level, correct?

6 A I mean it showed in that instance, yes. I mean I'm
7 saying that's what value recapture represented.

8 Q Now, there's a disagreement I take it between you and
9 Dr. Bernheim as to how to calculate the consumer side of the
10 two-sided price, isn't there?

11 A Yes.

12 Q You say that the consumer side of the price should be
13 measured by the value delivered to the cardmember rather than
14 the cost or the liabilities that American Express incurred to
15 deliver that value; is that correct?

16 A Certainly we're talking about price, yes.

17 Q Now, when you looked at market power and you were
18 determining the value to the cardholder on the consumer side
19 of the two-sided price, you looked at cost when you calculated
20 the two-sided price in connection with your Hypothetical
21 Monopolist Test, didn't you?

22 A Cost is one of the things I looked at because if it
23 doesn't change, then holding aside some things, there were
24 degradations in the quality of American Express's rewards
25 programs, it was saying they weren't making expenditures that

Katz - cross - Chesler

4147

1 would have increased the value, so it is an indirect way of
2 getting at it and I did use it, you're right.

3 Q Again, so in your SSNIP test analysis when you were
4 looking at market power on the consumer side, you looked at
5 cost, correct?

6 A No, ultimately I was saying there is no change in what's
7 going to that side so there was no change in benefits and the
8 way it is modeled is -- well, as I said, the monopolist raised
9 the price to one side and did not lower the price to the other
10 side.

11 Q And, in fact, you said that, "The principal way in which
12 I conducted the Hypothetical Monopolist Test was to consider a
13 net two-sided price, the costs of rewards and other benefits
14 are reflected in the equilibrium interchange fees or in the
15 case of American Express's proprietary issuing and internal
16 transfer price."

17 That's a correct statement that you gave?

18 A Yes.

19 Q And it looked at cost of the rewards and other benefits,
20 correct?

21 A Yes, and holding those constant was holding the rewards
22 constant, yes.

23 Q Now, it is your belief that American Express charges a
24 rate premium over its competitors and this is one of the
25 pieces of evidence that you referred to in connection with

Katz - cross - Chesler

4148

1 your assessment of market power?

2 A Overall it has a premium pricing strategy. It doesn't
3 charge premiums in every instance.

4 Q You agree that the existence of a premium does not in and
5 of itself prove the existence of market power, correct?

6 A That's correct.

7 Q Are you familiar with the concept of an oligopoly price
8 umbrella?

9 A Yes.

10 Q That's where you can have nondominant firms that are
11 behaving competitively but are able to achieve high
12 equilibrium prices because the larger firms in the market that
13 dominate have set high prices, correct?

14 A That is correct.

15 Q And it is possible that a nondominant firm competing with
16 an oligopoly can price even above the dominant firms if it
17 provides a differentiated product, correct?

18 A Yes.

19 Q And you also note, don't you, that Discover charges a
20 prime over Visa and/or MasterCard in some industry segments,
21 right?

22 A That's my recollection, yes.

23 Q In fact, if you take a moment and look at Defendant's
24 Exhibit 6507, this is in volume one, this was your second
25 report, page 99, Table 1-A, do you have that?

Katz - cross - Chesler

4149

1 A Yes, I do.

2 Q And you see if you look -- let me pull out four of these
3 lines under the acquirer interchange program, if you look at
4 public services, Discover is priced above Visa Traditional
5 Rewards, correct?

6 A I'm sorry, I just -- I was looking at the table. Which
7 one?

8 Q Public services, about a third of the way down.

9 A Okay.

10 Q Discover's rate to merchants is higher than Visa,
11 correct?

12 A The interchange rate, yes.

13 Q And the retail line, Discover is again higher than Visa,
14 correct?

15 A Higher than this particular Visa rewards card, yes. So,
16 when you say higher than Visa, yes, higher than the Visa card
17 listed here. That's different than a statement about higher
18 than Visa overall but certainly I stand by this table.

19 Q Indeed, you put the table together, correct?

20 A Yes.

21 Q And on the restaurant line Discover is higher than the
22 MasterCard Enhanced Card, correct?

23 A Yes.

24 Q And for card not present, E-commerce Discover is higher
25 than the Visa column, correct?

Katz - cross - Chesler

4150

1 A I'm sorry -- yes.

2 Q Do those prices indicate to you that Discover has market
3 power?

4 A No.

5 Q Now, you acknowledge that Visa and MasterCard charge
6 higher interchange fees for different types of credit cards,
7 those with higher rewards for example, correct?

8 A Yes, that's my understanding.

9 Q And the rewards cards for which Visa and MasterCard
10 charge higher rates, higher merchant fees are closer to, in
11 terms of their consumer benefits, closer to the American
12 Express cards, aren't they?

13 A Certainly that's my view that that's what's generally
14 true. I haven't looked at specific cards to match them but
15 that's my general impression, yes.

16 Q You recall in your reports and I think in your direct
17 testimony you talked a bit about doing comparison merchant
18 fees on a mix adjusted basis?

19 A Yes, that American Express does that.

20 Q And that's where American Express tries to map their
21 cards against particular Visa and MasterCard cards in order to
22 do an apples to apples comparison of merchant rates?

23 A That's a large part of what it's doing. I think the
24 testimony is somewhat unclear as to what else they're doing
25 because there's some discussion of matching cardholder

Katz - cross - Chesler

4151

1 characteristics as well.

2 Q All right.

3 Are you aware, sir, that Discover's president,
4 Mr. Hochschild, testified here at trial that in his view it is
5 necessary to adjust for mix in order to avoid the inaccuracies
6 that come from a comparison based on a blended average rate?

7 A First, mix has been used multiple ways in this litigation
8 and also blended rate has been used to refer to multiple
9 things. So, he could well have made such a statement but it
10 would be certainly helpful for me to know what kind of mix
11 we're talking about and what we're talking about being
12 blended.

13 Q I won't take the time because his testimony is in the
14 record, but did you read Mr. Hochschild's testimony, sir?

15 A I don't believe I read all of it. I certainly read large
16 parts, which is not to say I remember all of it.

17 Q Okay. Now, you've been informed that American Express
18 asserts in this litigation that at present on a mix adjusted
19 basis, that is mapping cards to cards of comparable consumer
20 benefit, American Express's average discount rate does not
21 reflect any premium over Visa and MasterCard?

22 A That has been relayed to me that American Express has
23 said that.

24 Q Now, given your testimony about the significance to you
25 of AmEx's overall premium as you described it in your direct

Katz - cross - Chesler

4152

1 testimony, if you assume it is correct that American Express
2 does not have a premium over Visa and MasterCard on a mix
3 adjusted basis, does that have any significance to your
4 testimony, sir?

5 A It would certainly play a role in my thinking. It would
6 not take away from the fact that American Express has long had
7 a premium pricing strategy and it would certainly raise
8 questions in my mind why American Express wasn't doing it but
9 it also would take away the current premium as a basis for
10 concluding they had market power.

11 Q It would take away the current premium as a basis for
12 concluding that American Express had market power, is that
13 your testimony?

14 A Yes, that's right. It wouldn't change the facts up to
15 that point but that would be something to consider.

16 Q Now, you're aware that American Express's expert,
17 Dr. Bernheim, found that smaller merchants are more likely to
18 pay higher all-in rates to Visa and MasterCard than they pay
19 for American Express?

20 A As I recall, he made a number of claims about that and I
21 had some serious reservations about several of the
22 calculations he did, so I do know he made some such claims, I
23 recall that.

24 Q Well, didn't you state, sir, that with respect to his
25 identifying the fact that smaller merchants that pay less for

Katz - cross - Chesler

4153

1 American Express transactions than for those on Visa and
2 MasterCard, he looked across a series of four separate figures
3 and he confirmed that the smaller merchants are more likely to
4 pay higher all-in rates to MasterCard and Visa and you said
5 that this finding was not a surprise to you?

6 A I may well have said that I mean, and I may be mis-
7 recollecting, but I thought he found merchants that accounted
8 for some tiny fraction of his sample. I may be mixing which
9 things -- he and I did a lot of things in the course of
10 writing our reports. There was certainly -- if you look at a
11 large number of merchants, it is certainly not surprising that
12 some would go one way and some the other.

13 Q Okay. Now, you talked in your direct testimony about
14 insistence as a source of AmEx's market power, correct?

15 A Yes, I did.

16 Q And you agree that by itself high levels of insistence do
17 not establish that American Express has antitrust market
18 power, correct?

19 A That's correct.

20 Q I take it you also agree that a firm with a very small
21 market share may be unable to set prices above competitive
22 levels even if its cardholders have a high degree of
23 insistence, correct?

24 A If your cardholders had a high enough degree of
25 insistence you might be able to set the price for your

Katz - cross - Chesler

4154

1 cardholders above the competitive level by some degree because
2 of the fact you have insistence, that's the nature of
3 two-sided platforms and what in economics it's referred to as
4 having a bottleneck. So, there is a feature of two-sided
5 platforms where you can have a small share and still have the
6 ability to raise the price just for your product.

7 MR. CHESLER: Let's look at Defendant's Exhibit 6540
8 again.

9 You know, Your Honor, before I do that, I just
10 reminded myself, I think I did not say that I wanted to offer
11 the two most recent charts we looked at as A and B from a
12 different report of Dr. Katz's. When we take a break, I'll go
13 back and figure out which two those are and offer them.

14 THE COURT: 6507 A and B?

15 MR. CHESLER: 6507 A and B.

16 THE COURT: It may be too late to do that.

17 MR. CHESLER: Is there a rule that I fall on the
18 wrong side of?

19 THE COURT: A two minute rule. If you ask too many
20 questions afterwards, you're out of luck.

21 MR. CHESLER: I should have known.

22 THE COURT: Is there any objection with regard to
23 tables?

24 What is it, the table on 99 and 100, is it, those
25 two tables?

Katz - cross - Chesler

4155

1 MR. CHESLER: I think it was actually just the one
2 on 99.

3 THE COURT: So, that would just be A.

4 MR. CHESLER: 6507 A, yes, sir.

5 THE COURT: Any objection as a demonstrative
6 exhibit?

7 MR. CONRATH: No.

8 I want to make sure I'm talking about the right
9 thing. This is the table from Dr. Katz's report, Table 1-A at
10 page 99?

11 THE COURT: Yes.

12 MR. CONRATH: I have no objection.

13 THE COURT: Of DX 6507?

14 MR. CONRATH: No objection.

15 THE COURT: All right. 6507 A is received in
16 evidence.

17 You'll provide me with a marked copy.

18 MR. CHESLER: Yes, Your Honor, we will.

19 THE COURT: As a demonstrative exhibit.

20 MR. CHESLER: Yes.

21 (Defendant's Exhibit 6507 A so marked in evidence.)

22 THE COURT: Let's move on.

23 THE WITNESS: I apologize, could I ask if I could do
24 one thing, when you are referring to my reports could I use a
25 copy I brought because you used higher gloss paper and I

Katz - cross - Chesler

4156

1 recently had a retinal tearing surgery and the light
2 reflecting off of this is causing problems for me reading.

3 MR. CHESLER: Of course.

4 THE WITNESS: If it is okay with you.

5 MR. CHESLER: Of course.

6 THE COURT: And they are unmarked copies.

7 MR. CHESLER: I will just point out to the Court
8 that I always examine witnesses from blue paper for that exact
9 reason.

10 THE COURT: I thought there was a law at your law
11 firm.

12 MR. CHESLER: There is, Your Honor, but as the
13 chairman, I was trying to be egalitarian so I didn't want to
14 mention that. Now that you've outed me --

15 THE COURT: I've ordered ten cases of blue paper.

16 MR. CHESLER: It would be good for the blue paper
17 industry.

18 THE COURT: Yes, I suppose but it will raise the
19 price.

20 MR. CHESLER: It will, that's true. I think it is a
21 one-sided market.

22 Q Of course you can use your version of it.

23 A Thank you.

24 Q So, we're going to look at 6540 which is your third
25 report, that is your --

Katz - cross - Chesler

4157

1 A Surrebuttal.

2 Q Surrebuttal.

3 And I'd like you to look at paragraph 604 which
4 begins on page 340. I'm really interested in the part of
5 paragraph 604 that appears on the next page but why don't you
6 take a moment and look at the whole paragraph.

7 (Continued on next page.)

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1 CROSS-EXAMINATION (continued)

2 BY MR. CHESLER:

3 A Okay. I have looked it over.

4 Q And you see that beginning in about the fourth line down
5 from the top on page 341 you say: "Hence, a firm with a very
6 small market share may be unable to set prices above
7 competitive levels even if its cardholders have a high degree
8 of insistence. Moreover, the ability to set prices greater
9 than the competitive level is not equivalent to the ability to
10 harm competition more broadly through policies such as the
11 merchant restraints. As discussed in my initial report,
12 market shares play an important role in the ability to impose
13 restrictions such as American Express's merchant restraints.
14 In this regard, it's notable that American Express's charge
15 volume is approximately five times Discover's."

16 Do you see that, sir?

17 A Yes, I do.

18 Q And do you agree with your statement in that context that
19 "hence, a firm with a very small market share may be unable to
20 set prices above competitive levels even if its cardholders
21 have a high degree of insistence"?

22 A Yes. So to make sure the record is clear about what I
23 was saying before, there's circumstances where you could have
24 a very low market share and because of insistence have the
25 ability to set prices above the competitive level due to

Katz - Cross / Chesler

4159

1 what's known as having this bottleneck effect. What I've
2 identified here, and I believe correctly so, is saying that in
3 this particular industry, there are some setup costs or fixed
4 costs that also come into play and could be an offsetting
5 factor.

6 Q Now, I'd like you to go back to an exhibit we looked at
7 yesterday, which is Defendant's Exhibit 1917 which is in
8 Volume 2 and it's already in evidence. This was the
9 presentation to the American Bar Association in 2004 "Payment
10 Networks, the Antitrust Perspective."

11 Do you have that, sir?

12 A Yes, I do.

13 Q Now, if you look at page seven which has a Bates number
14 that ends '721, you pose the question on that page: "Can a
15 firm have market power on one side of the market but not the
16 other?"

17 Do you see that, sir?

18 A Yes, I do.

19 Q And then under that the first bullet reads: "Competition
20 to serve the side for which there is no market power will lead
21 to complete rent dissipation. Hence, there is no meaningful
22 market power for the intermediary."

23 Now, would you just explain to the Court what the
24 first bullet means: "Competition to serve the side for which
25 there is no market power will lead to the complete rent

1 dissipation"?

2 A So, what here it's saying is you had perfect competition
3 on the one side and if you're asking where the perfect is it's
4 implied in the complete rent dissipation. So it's saying if
5 you have perfect competition on one side of the market, that
6 any gains you've got on the other would be dissipated on this
7 side.

8 Q And in fact, you went on to say that that concept, that
9 having market power on one side of a two-sided market but not
10 on the other will persist, was contradictory to the
11 government's position in the U.S. v. First Data case, correct?

12 A That's what it says, yes.

13 Q And that's the case where you testified opposite the
14 government and testified about the nature of that two-sided
15 market, correct?

16 A That's correct.

17 Q Now, in the same presentation you also pointed out that
18 this conclusion regarding the market power of the intermediary
19 contradicted the government's position, as we just saw.

20 Do you recall what the government's position was
21 that this principle contradicted?

22 A What I recall about it is that the government was
23 focusing on changes in the interchange rate as a measure of --
24 of market power and I would think from that then it's saying
25 well, if you change the interchange and it goes up to the

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1 issuing side, that then the issuing side would dissipate. I
2 believe that's what this is referring to, but I'd have to
3 reconstruct it from ten years later.

4 Q The government in the First Data case was taking the
5 position that the merger that you were proposing or you were a
6 proponent of would have the effect of raising interchange
7 rates on the merchant's side of the market?

8 A No, interchange rates -- right, interchange rate is a
9 passthrough rate. So yes, they were saying that it would go
10 up on the merchant's side, but then as part of the definition,
11 it would go down on the other side. I mean, that's what it
12 means to be an interchange rate. You can't change just one
13 side of it.

14 Q And you took the position, as we saw yesterday, that by
15 looking only at one side of the market, the government was, in
16 your words, telling only half the story, correct?

17 A Yes, with the interchange rate, certainly.

18 Q Now, you're aware that American Express routinely pays
19 consumers and corporate cardholders to use its cards, right?

20 A Yes.

21 Q And that, in fact, American Express offers a rewards
22 program that many cardmembers find attractive, correct?

23 A Yes.

24 Q And that's a big part of American Express's value
25 proposition, an element of its success?

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1 A Yes, that's my understanding.

2 Q And you understand that American Express uses rewards to
3 attract and retain cardmembers and encourage them to use their
4 cards when they go to merchants to make purchases?

5 A Yes, I assume that's the point of paying the rewards.

6 Q And you also agree that if American Express were to cease
7 offering a competitive rewards program, it would see a
8 significant decline in its cardmember insistent levels,
9 correct?

10 A Yes, I would expect that.

11 Q And it would see a significant decline in its charge
12 volume if it were to cease offering a competitive rewards
13 program, correct?

14 A Yes, if it didn't substitute it with something else, yes.

15 Q And if in fact it had a less attractive rewards program,
16 it would have a lower share of spend than it has today,
17 wouldn't it?

18 A Again, unless it did something offsetting, yes.

19 Q Now, at your deposition I asked you what factors, in your
20 view, tend to enhance brand loyalty in this industry, the
21 credit card industry, and you recall that you said that so
22 long as the consumer continued to have good experiences with
23 the card provider and with using the card, it would remain a
24 user and you called that loyalty; do you recall that, sir?

25 MR. CONRATH: Can we have a page and line, Your

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1 Honor?

2 A I don't recall saying that, but that's -- I agree with
3 the statement.

4 Q All right. Let's look at your deposition, which is the
5 first tab in Volume 1, transcript page 231.

6 A I'm sorry, you said page 231?

7 Q Yes, sir, I did.

8 A Thank you.

9 Q You have that page, sir?

10 A Yes.

11 Q All right. And I'd draw your attention to line 7 on 231
12 of your deposition. My question: "So far as you're aware,
13 what factors tend to create an enhanced brand loyalty in the
14 credit card industry?

15 "Answer: If a consumer thinks that he or she is,
16 you know, getting particularly high value from using a
17 particular card, I would expect that that consumer would be
18 more loyal to that card in the sense of preferring to use it,
19 and as long as that consumer continued to have good
20 experiences with the card provider and with using, it would
21 remain a user and I would call that being loyal.

22 "Question: Could that value, for example, come in
23 the form of rewards?

24 "Answer: Yes."

25 And then your testimony goes on.

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1 MR. CONRATH: Your Honor, I object to not reading
2 the complete answer.

3 THE COURT: Yeah, read the rest of the answer,
4 please.

5 MR. CHESLER: Okay.

6 Q "I should also state though since we brought up this
7 issue about marketing, there are people who would say that's
8 not evidence of loyalty at all, somewhat the way a friend of
9 mine once said that dogs are loyal and he said they're loyal
10 only as long as you're feeding them. So that's why there's a
11 debate in marketing about what we mean by loyalty. So that's
12 why single-homing is not necessarily equivalent to the
13 concept."

14 And then I asked you: "Well, to use your dog
15 analogy might be analogous to they are loyal so long as they
16 keep getting the rewards?

17 "Answer: Yes."

18 Do you recall giving that testimony, sir?

19 A I certainly remember the dog testimony, yes.

20 Q And do you stand by the dog, sir?

21 A As long as he doesn't bite me, yes.

22 Q Thank you.

23 And you would also agree, would you not, that there
24 are no significant barriers that face issuers from offering
25 rewards programs similar to American Express's?

1 A Be careful I guess by what with he mean by barriers. I
2 think a lot of thinking and research and experience has gone
3 into developing American Express's rewards programs, and I
4 believe witnesses have testified to that at trial, but there's
5 nothing to stop somebody else from trying and there are other
6 successful rewards programs.

7 Q And Discover believes that it offers an effective rewards
8 program, right, its cashback program?

9 A Yes, I believe they're proud of it.

10 Q And despite that program, you would agree that they have
11 not been able to achieve ubiquity that Visa has on the issuing
12 side of the market, correct?

13 A I'm sorry, by ubiquity on the issuing side are you saying
14 that they don't have anywhere near the number of third party
15 issuers that Visa does, is that the question?

16 Q And anywhere near the number of cards-in-force as Visa
17 has, correct?

18 A Yes.

19 Q And when I asked you if you knew why that was the case,
20 you said you did not, you'd be speculating. That's at page
21 205 of your deposition.

22 Do you recall that you gave that testimony?

23 A I don't recall saying that.

24 Q Why don't you look at page 205. You can read the prior
25 testimony, if you'd like, and just it really begins with the

1 prior question, line 3:

2 "You agree that in the general purpose credit and
3 charge market you've defined Visa has a significantly higher
4 share than Discover?

5 "Yes.

6 "And it has significantly higher share than Amex
7 has?

8 "Answer: For some purposes, sure, it's significant.

9 "Question: Do you have a view as to why on the
10 issuers' side of the market Discover has not been able to
11 achieve ubiquity that Visa has?

12 "Answer: No, I would be speculating."

13 Does that refresh your recollection, sir?

14 A Yes, although it does raise the question here what I
15 thought you meant when you said "ubiquity," but it's certainly
16 what I said there.

17 MR. CHESLER: Your Honor, I have a note that the
18 courtroom system is apparently down. So we're not publishing
19 anything on the screens. I don't know that there's much to be
20 done about it, but I just -- apparently the technology folks
21 are working on it.

22 (Pause.)

23 THE COURT: There's something up there now. Is that
24 what you're publishing?

25 MR. CHESLER: Yes, that was the page of the

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1 transcript we were just looking at.

2 THE COURT: Then we're up.

3 MR. CHESLER: Thank you, Your Honor.

4 THE COURT: Okay?

5 MR. CHESLER: Thank you.

6 THE COURT: It's up on the screen here.

7 Thank you. Go ahead.

8 BY MR. CHESLER:

9 Q Now, with respect to this issue of insistence, do you
10 agree, sir, that there are often consumers who are loyal in
11 some sense to the merchant with whom American Express is doing
12 business?

13 A Yes, that's why the insistence numbers are less than a
14 hundred percent.

15 Q And in fact, what's going on is there are some consumers
16 who are more concerned with using their American Express Card
17 than with the particular merchant and there are some consumers
18 who are more concerned with doing business with the particular
19 merchant than with using their American Express Card; is that
20 fair?

21 A Yes.

22 Q Now, if you'd look, please, at Defendant's 6466, this is
23 your first report, and at page 322.

24 A I'm sorry, could you give me a figure or table number,
25 because if I use my copy --

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1 Q Table 22.

2 A Thank you, because my copy doesn't have pagination at
3 that point.

4 Q Okay.

5 THE COURT: We're not publishing this, are we?

6 MR. CHESLER: No, Your Honor.

7 Q Do you have that?

8 A Yes, I do.

9 Q And so if you look at the total insistence column in the
10 middle, would you agree with me that across, assuming these
11 figures are accurate, across every industry, less than half of
12 the cardmembers are insistent, that is insistent on using
13 their American Express Card?

14 A Subject to one amendment. I believe insistence is done
15 in terms of charge volume, not numbers of cardmembers, but if
16 you're using it just as a shorthand, certainly I agree.

17 Q And I take it you would agree, sir, then in any
18 negotiation between American Express and a merchant, if the
19 result of that negotiation were to be that American Express
20 and the merchant no longer did business together directly,
21 while the merchant faces the prospect that some number of
22 consumers will no longer shop at her store, American Express
23 faces the prospect that some number of its cardmembers may use
24 someone else's card to continue shopping at that store?

25 A Yes.

1 Q So it's a two-edge sword, so to speak, in that
2 negotiation in which both sides may well have something to
3 lose, correct?

4 A Yes.

5 Q And are you familiar with the concept in the card
6 industry of spillover?

7 A I believe it's used more than one way, but yes.

8 Q Let me be sure we're using it the same way for these
9 questions. I'm intending to use spillover as the phenomenon
10 that if a card loses acceptance at a particular merchant it
11 may result in that particular consumer who's using that card
12 using it less at other merchants other than the one at which
13 it's been cancelled.

14 A Yes.

15 Q Okay.

16 A I'm not sure -- okay, I understand that that's the
17 concept that you're talking about here.

18 Q All right. Have you done any research on your own into
19 the significance of an impact of the spillover effect as I've
20 just defined it?

21 A No.

22 Q Moving to a somewhat different topic.

23 Did you read Mr. Conrath's opening statement to the
24 Court?

25 A I'm not sure I did. I know I was provided a copy, but

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1 with apologies to Mr. Conrath, I may not have.

2 Q He doesn't seem to be getting a lot of -- you didn't
3 remember he was in the First Data case, you didn't read his
4 opening statement.

5 MR. CHESLER: I don't know why you stand for it.

6 A I'm sorry, I may have. I just --

7 Q It just wasn't memorable, is that what you're saying?

8 A Possibly.

9 Q I'm only kidding.

10 THE COURT: I heard it, so I'm not as concerned
11 about the witness.

12 MR. CHESLER: Thank you, Your Honor.

13 THE COURT: Go ahead.

14 Q One of the things Mr. Conrath said in his opening is:
15 "If merchants could steer price competition breakout,
16 merchants could save money."

17 Doesn't surprise you that he said that, does it?

18 A No.

19 Q Now, I take it that you're aware that the government
20 called a number of merchant witnesses during the course of its
21 case-in-chief here?

22 A Yes.

23 Q Are you aware that the government called no consumers and
24 no consumer group representatives?

25 A I'm certainly not aware of it having called any. I

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1 haven't looked at the complete witness list, but I don't
2 recall any.

3 Q Did you find that in the group of merchants called by the
4 government, virtually all of them came from the finance
5 function in their companies as opposed to the marketing
6 function?

7 A I'd have -- I'm not sure I recall all the titles, but the
8 ones I do recall I guess would be in a finance function. I
9 know that like for Southwest I think it's the person who dealt
10 with payments and I'm not sure which part of the company
11 that's in, but that's what I recall.

12 Q Now, going back for a moment to the Visa case again.

13 MasterCard had an expert in that case by the name of
14 Pindyck, correct?

15 A That's correct.

16 Q Robert Pindyck?

17 A Yes.

18 Q And Professor Pindyck also focused on the level of
19 merchant discount rates and he made claims about American
20 Express's rates being too high, didn't he?

21 A Yes. I think he was saying they were too high from the
22 perspective of overall consumer welfare, yes.

23 Q And in fact, he argued that if the exclusionary rules
24 were eliminated, American Express would use issuing banks to
25 which it would then have access to increase the volume of

1 transactions that would be charged at higher discount rates to
2 merchants, didn't he?

3 A I'd have to recall specifically. I believe his
4 testimony, as I sit here my recollection is he said that
5 interchange rates would be driven up so that merchants would
6 be paying more and that more money would be paid to the
7 issuers' side than the consumers'. I think it was about
8 interchange, but I'd have to go back and look.

9 Q All right. I think we're in agreement on that.

10 Now, you responded, part of your role was to respond
11 to Professor Pindyck, wasn't it?

12 A Well, my role was to analyze, you know, the economic
13 issues in the case, and certainly I took into account what he
14 said and I responded where I thought he, you know, he either
15 had a good point or a bad point, yes.

16 Q And one of the things you responded to Professor Pindyck
17 about was you said that his focus on discount rates was
18 unsound, didn't you?

19 A I think if we're talk -- yes, if we're talking about
20 interchange, his focus exclusively on discount rates is
21 unsound, yes.

22 Q And you testified that by focusing solely on one
23 dimension of a multidimensional competitive behavior, he was
24 providing an incomplete, and thus misleading, picture of
25 economic effects.

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1 Wasn't that your testimony, sir?

2 A Yes.

3 Q And you said that merchant and consumer welfare has to be
4 measured in terms of the total package of benefits that they
5 receive, not just the merchant discount rate, correct?

6 A So because this was in your opening statement, I actually
7 had -- this is something I had gone back and looked at. So I
8 want to just clarify a couple of things.

9 One, the consumer there is meaning consumer in the
10 everyday use of the word. So that's why it's in -- it's what
11 I would have said in current terminology as merchant and
12 customer, but yes, I said it was about both of them. And that
13 that statement was saying you have to look not just at price,
14 but also at quality.

15 MR. CONRATH: Could I object to the fact that
16 apparently the witness read Mr. Chesler's opening statement
17 but not mine?

18 THE COURT: When you get his bill, you can adjust.

19 MR. CONRATH: I am delighted that he saved the time
20 that would have been wasted reading my opening.

21 MR. CHESLER: I'm not good at taking --

22 THE COURT: I'm very impressed, Mr. Chesler, about
23 the fact that the witness is so familiar with your work.

24 THE WITNESS: Not as familiar as he is with mine.

25 THE COURT: Apparently so.

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1 Go ahead.

2 MR. CHESLER: Thank you, Your Honor.

3 BY MR. CHESLER:

4 Q So picking up on the last answer you gave that it's also
5 necessary to be concerned about quality as well as price, you
6 remember just saying that a few minutes ago?

7 A Yes, I do.

8 Q So you are of the view that you have to take into account
9 changes in the nature and quality of products and services
10 that both merchants and consumers receive, correct?

11 A Yes.

12 Q And in the context of the elimination or the possible
13 elimination of the exclusionary rules, that, in your view, was
14 an important consideration in addition to whatever the impact
15 might be on the discount rate, correct?

16 A Yes, in that case, certainly.

17 Q In fact, you recognized in the Visa case, didn't you,
18 that removing the exclusionary rules could actually result in
19 increasing merchant fees?

20 A I -- yes, through raising the interchange rate, yes.

21 Q And in fact, after the exclusionary rules were
22 eliminated, merchant fees increased, didn't they?

23 A The interchange fees did go up after that, resulting in
24 an increase in the merchant discount fees, although one has to
25 be careful whether one attributes it to that litigation or the

1 outcome, for example, the Wal-Mart litigation and other
2 factors, but yes, merchant discount rates did go up in the
3 years following that litigation.

4 Q And the interchange, I think we've established, is by far
5 the largest component of the merchant fee in the card
6 industry, correct?

7 A Yes.

8 Q And one of the things that you emphasized in First Data,
9 moving from Visa to First Data.

10 A Thank you.

11 Q One of the things you emphasized in First Data was that
12 it was very important to acknowledge that increased
13 interchange fees which the government was saying would occur
14 in the presence of that merger were in fact passed back to
15 consumers both directly in rewards and indirectly in the
16 overall services that issuers provide to consumers, correct?

17 A I don't recall saying the second part, but I would
18 certainly agree with the -- that economic analysis, and I do
19 recall the first part.

20 Q And to sum up this point, your view in First Data was
21 that because of the two-sided interrelated nature of the
22 market, it was incorrect to think that the effects of
23 interchange fees on consumer welfare can be understood by
24 looking solely at the merchant side of the market?

25 A Yes.

1 Q Isn't it true, sir, that in this two-sided payment
2 market, in examining competitive effects, it is improper to
3 equate an increase in network charges to merchants with harm
4 to competition or consumers?

5 A The increase itself, yes, it would depend on the process
6 that gave rise to the increase.

7 Q And in fact, an increase in merchant fees can be the
8 result of increased competition, not a sign or consequence of
9 harm to competition; isn't that true?

10 A I want to actually just clarify one thing. It probably
11 won't change my answer, but I want to make sure the record is
12 clear.

13 Are you asking me when you said, we were talking
14 about First Data and you started to say this market. Are you
15 still talking about what the government alleged was a separate
16 market for PIN debit, or are you talking about --

17 Q Yes, I'm talking about your views in the context of the
18 First Data case. If I didn't make that clear, I apologize.

19 A I'm sorry, I think it was clear by implication, but I
20 just wasn't sure. I'm sorry, if you could just ask the
21 question again.

22 Q Let me ask that second question again.

23 In fact, isn't it true that an increase in merchant
24 fees can be the result of increased competition, not a sign or
25 consequence of harm to competition?

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1 A Yes.

2 Q And that in a two-sided market, interchange rates can and
3 have been driven up by an increase in competition, correct?

4 A Now, so you're now asking generically?

5 Q Yes. I'm quoting from your First Data testimony, but I
6 quoted it exactly you gave it "in a two-sided market."

7 A Yes, I agree with that statement.

8 Q Thank you.

9 Now, is it similarly true, sir, that if interchange
10 rates were to be lowered, that can harm consumers through the
11 resulting effects on card issuers' pricing and service
12 quality?

13 A Yes.

14 Q And can an increase in interchange rates also increase
15 merchant welfare as well as consumer welfare?

16 A In theory, yes.

17 Q For example, an increase in interchange could provide
18 incentives for issuers to offer card features like rewards
19 that encourage consumers to use their cards with the merchants
20 and that can benefit the merchants, correct?

21 A Depending on what the payment alternatives are, it could
22 be the case, yes.

23 Q I just want to ask you a bit about the but-for world that
24 you considered in connection with this case.

25 A The present case.

1 Q Now, that would be a world in which American Express did
2 not have these non-discrimination provisions in its merchant
3 agreements, correct?

4 A Yes.

5 Q And by necessity, that's a hypothetical world, right?
6 You didn't have an actual model to examine, correct?

7 A That's -- that's correct.

8 Q And you would agree, would you not, that it is possible
9 that the actual discount rate to merchants might rise over
10 time in that but-for world, correct?

11 A Certainly.

12 Q Now, if the merchant rates went up in the but-for world
13 and the benefits to consumers went up even more, the value to
14 consumers exceeded the increase in merchant fees, your view is
15 that that would be an improvement in the quality adjusted
16 price, as you call it, correct?

17 A If I understand your hypothetical correctly, yes.

18 Q Now, you know that the merchant testimony in this case
19 has been different from that, don't you, that the merchant
20 testimony here has been that if the discount rate went up and
21 benefits to consumers went up even more, that would,
22 nevertheless, from the merchant's perspective, be a bad thing.

23 Are you aware of that testimony?

24 A I'm aware that some of them have said that. I don't
25 believe that I've reviewed all of the merchants testimony on

1 that subject.

2 Q And the reason that the merchants have come here and
3 admitted that is because they're looking at only one side of a
4 two-sided market; isn't that true?

5 A Well, certainly the part that they're most concerned
6 about is their side and their profits, but I think it's
7 probably inaccurate to say they've looked at only one side of
8 it. They have quite a lot of concern about what's going on on
9 the other side. I mean, that's why they take credit and
10 chargecards and that's why they take American Express is
11 precisely because they're concerned about what's going on on
12 the other side, but I agree with the statement that at the end
13 what they're concerned with is their profitability.

14 Q And so concerned with their profitability that some of
15 them have come in here and said "if my rates were to go up in
16 the but-for world and consumer benefits were to go up even
17 more, that would still be bad from my perspective," correct?

18 A I believe they've said things that implied that. I don't
19 recall if someone said exactly that. I certainly would not be
20 surprised to learn that some had that opinion.

21 Q Well, in the trial transcript I'm reading, Your Honor,
22 from transcript page 1424 and 1425, this is Mr. Rein from
23 Wal-Mart. I'll just read this to you and see if you are
24 familiar with this.

25 "Question: Suppose the cost to Walgreens of

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1 accepting a credit card went up by 50 basis points in a
2 particular year, costs you half a percent more of your sales
3 in that year than it had the year before, do you understand
4 that assumption?

5 "Answer: Yes.

6 "Question: But suppose that in the same year, the
7 value of rewards that credit card customers were getting from
8 the credit card companies went up 100 basis points, one
9 percent increase in the value of the rewards.

10 "Question: Is that a good thing or a bad thing from
11 your perspective at Walgreens?

12 "Answer: It depends on what they're purchasing. If
13 they purchase all sale items, we lose money due to production
14 costs, logistics costs, payroll costs. It just depends on
15 what they purchase.

16 "Question: If your cost of acceptance goes up, that
17 is not something that you want to happen, right?

18 "Answer: That is correct.

19 "Question: The fact that the rewards value to the
20 customers have gone up doesn't change the fact that your costs
21 have gone up, so that is not a good thing for Walgreens,
22 correct?

23 "Answer: Right."

24 Now, were you familiar with that testimony, sir?

25 A I don't recall that testimony.

1 MR. CONRATH: I think just for the record, Your
2 Honor, if I heard it correctly, counsel misspoke and said
3 "Wal-Mart" instead of "Walgreens," but just to have a clear
4 record, I think Mr. Rein is from Walgreens.

5 MR. CHESLER: He certainly is and if I said
6 "Wal-Mart," I apologize, Your Honor.

7 THE COURT: That's all right.

8 A You said it once and then you said "Walgreens" the second
9 time.

10 Q All those W's confuse me.

11 So to the extent that Mr. Rein expressed those
12 views, I understand you say, and I agree with you frankly,
13 that merchants accept credit cards and whatever they accept
14 for payment is because of what consumers want and that's on
15 the other side of the market, but to the extent Mr. Rein
16 expressed the views about it not being good if his fees went
17 up even if reward value went up even more, that's because he
18 was, in that context, primarily focused on his side, correct?

19 A Well, actually, I don't fully agree with what you're
20 saying, but I don't want to be up here arguing with you
21 because the testimony speaks for itself, but actually the way
22 the questions were asked, it seemed to me he gave a much
23 narrower answer because he said there were specific questions
24 that said 'well, the part about the fees going up, that would
25 be bad for you' and he said 'yes, that would be,' but that

1 actually broke off that part from the rest. I don't -- I
2 didn't take away from that that he was offering an overall
3 assessment of welfare.

4 As I said, my assumption as an economist is that had
5 you asked him about the overall situation, or whoever was
6 examining, he would have said that, but that was not what I
7 heard from the testimony you read.

8 Q Okay. Now, you testified that, in your deposition in
9 this case, that you would expect Discover to be more
10 successful with its low-cost-to-merchant strategy in the
11 but-for world, correct?

12 A Yes.

13 Q And you agree that Discover has significantly lower
14 relevance rates than Visa and MasterCard, correct?

15 A Yes. Let's just be careful, I mean, because relevance, I
16 understand, is a broad concept, but it also gets used
17 different ways in the industry. So perhaps you could just
18 tell me what you mean by it just to make sure we're on the
19 same page.

20 Q Well, why don't we look at your deposition page 516.

21 Do you have it, sir?

22 A Yes, I do.

23 Q I'm looking at line 16 of page 516.

24 "Question: Do you agree that Discover has
25 significantly lower relevance rates than Visa and MasterCard?

1 "Answer: Yeah. I don't know if there are any
2 merchants where that's an exception, but as a broad matter,
3 yes."

4 What did you, if you recall, what did you understand
5 relevance to be when you gave that answer, sir?

6 A So, I don't recall specifically what I was thinking then,
7 but generally think of relevance as some notion of the overall
8 charge volume that the merchants can see of people who would
9 be wanting to use Discover cards.

10 Q Okay.

11 A But as I said, there are also sometimes a variance of
12 that, but they're all getting at some notion of the
13 significance to the merchants of customers wanting to use that
14 particular network's cards.

15 Q Thank you.

16 And you also agree that Discover has significantly
17 lower single-homing rates than Visa or MasterCard, correct?

18 A Yes.

19 Does it say that?

20 Q And single-homing meaning people that use just that one
21 card?

22 A We would have to go back and look in context because
23 single-homing generally means people using, favoring a
24 particular card or primarily using it. The strongest version
25 of single-homing is you carry only one credit and charge card.

1 The term is also used in the industry and in economics
2 literature sometimes to mean people that it's the card you use
3 most of the time. There's a range of concepts, but I'm
4 guessing that this one in context was talking about the strict
5 form of single-homing. Certainly for the strict form of
6 single-homing it would be a correct statement.

7 Q Strict form meaning a person who carries only that card
8 in her wallet, correct?

9 A Yes.

10 Q And you also agree that Discover has fewer cards-in-force
11 than Visa and MasterCard, correct?

12 A Yes.

13 Q Now, at the same time, Discover is accepted at many more
14 merchant locations than American Express, correct?

15 A Yes.

16 Q Discover has more cards-in-force than American Express in
17 the United States?

18 A I -- that's my recollection, but I'll have to check.

19 Q Do you recall it's something like 10 million more, 60-odd
20 million as opposed to 50-odd million?

21 A No, I'm afraid I don't, but it's my recollection they
22 have more cards-in-force.

23 Q And although it's accepted at millions more merchant
24 locations and has some significant number of more
25 cards-in-force, whatever that is, it has a share of spend

1 about one-fifth of American Express's, correct?

2 A That's correct, that's my recollection.

3 Q And so I take it the math would demonstrate that although
4 there are more people walking around, apparently, with
5 Discover cards in their wallets, or at least available to
6 them, and more merchants where they could use them, they're
7 spending much less on the cards, correct, than they are on
8 American Express cards?

9 A That's right, American Express has a much higher spend
10 per card.

11 Q And you would infer from that that American Express has
12 somehow managed to provide a more compelling value proposition
13 to the people that have its card than Discover has, wouldn't
14 you?

15 A No, I would infer from that that American Express has put
16 forth a value proposition that appeals to people who purchase
17 a lot on their cards. In fact, I think Discover's value
18 proposition is viewed very favorably by the people who hold
19 Discover cards, but those people have different
20 characteristics than the -- you know, on average, I'm sure
21 there's some overlap, but on average the people who hold
22 Discover cards have different spend characteristics than the
23 people who hold American Express cards.

24 Q Now, staying just for one more minute with this but-for
25 world with respect to this case.

1 You testified before that it's possible that
2 merchant fees would go up, right?

3 A Following this case, yes.

4 Q And in fact, your view is that although they may go up,
5 that we should just let the chips fall where they may. Isn't
6 that your view, sir?

7 A If the chips are falling where they may as a result of
8 increased competition, yes, that is my view.

9 Q So if all of the merchants who came in here, merchant
10 after merchant after merchant, and said "my rates are too
11 high, they need to come down" and if Mr. Conrath in his
12 opening said "if we win this case, merchant rates will come
13 down," and if it turns out that your proposition that they may
14 go up turns out to be correct that's fine would you?

15 A It would depend on why they went up, but if the reason
16 they went up is competition, that would be fine with me.
17 There's certainly other reasons that they could go up that I
18 would say they're not fine with me, by which I mean in
19 conducting an antitrust non-economic analysis I would find
20 that there is a problem.

21 Q Thank you. Let me move to a different subject.

22 You agree, do you not, that many agreements between
23 vertically-related parties can have procompetitive effects?

24 A Yes.

25 Q And in fact, a vertical restraint is not necessarily

1 anticompetitive simply because it restricts some form of
2 horizontal competition, correct?

3 A Correct.

4 Q And in fact, even the most exclusive form of vertical
5 arrangement and exclusive dealing arrangement where the
6 parties agree that they're the only ones who will do business
7 together for a particular service or product can, in fact, be
8 procompetitive, can it not?

9 A In some circumstances, yes.

10 Q And exclusive dealing arrangements are explicitly
11 permitted by the government's decree with Visa and MasterCard
12 that settled their portion of this case, aren't they?

13 A Yes, I believe that's correct.

14 Q And by definition, exclusive dealing arrangements have an
15 impact on horizontal competition, don't they?

16 A They can. They could have effects either direction, yes.

17 Q Now, when a vertical restraint has an impact on
18 horizontal competition, it's often on inter-brand competition,
19 correct?

20 A I'm sorry, inter?

21 Q Inter-brand.

22 A I mean, the effects of a vertical restraint can be felt
23 throughout the markets, so yes, the effects can be felt on
24 inter-brand competition. I'm not sure -- yes, if you're just
25 asking about the word "effects" and you don't mean the scope

1 of the contract, yes, the effects can be on inter-brand
2 competition.

3 Q Okay, and I think we all understand this, but for clarity
4 of the record, inter-brand competition is competition between
5 two distinct brands as compared to intra-brand competition,
6 which is competition between multiple suppliers of the same
7 brand, correct?

8 A Let me just to clarify. It might be better if we said
9 multiple retailers of the same brand because suppliers gets
10 into the question of whether you're talking about the
11 manufacturer.

12 Q All right. So let me restate the question.

13 Inter-brand competition would be illustrated by
14 competition between different distinct brands of products,
15 correct?

16 A Yes.

17 Q And that could take place at a single retailer or
18 multiple retailers, correct?

19 A That's correct.

20 Q And intra-brand competition would be competition among
21 multiple retailers who were selling the same brand, right?

22 A Yes.

23 Q And would you agree that a vertical restraint can have
24 beneficial effects on both forms of competition?

25 A Yes.

Katz - Cross / Chesler

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1 Q So if the government has argued to this court that a
2 vertical restraint can have beneficial effects only when it
3 restricts intra-brand competition, you would disagree with
4 that, wouldn't you?

5 A I'll have -- I think there can be situations where -- I'm
6 sorry, I want to make sure I understand something. This is
7 where we're getting to the effects versus restrictions.

8 Can you ask your question again because this is
9 harping back to the earlier question I had about exactly what
10 you're asking? So if you could ask it again.

11 Q To the extent that the government has argued to this
12 Court that a vertical restraint can have beneficial effects
13 only when it restricts intra-brand competition, you would
14 disagree with that, wouldn't you?

15 A Yeah, I think theoretically it would be possible to have
16 vertical restraints that might have restriction on some part
17 of inter-brand. I mean, I have to think about the theory, but
18 I think that's possible.

19 Q Thank you. Let me ask you and about an issue that's come
20 up at the trial concerning the rate complexity in this
21 marketplace.

22 Are you aware that a number of parties have come
23 before the court to seek confidential treatment for merchant
24 rates that are being paid to the various card networks?

25 A I know, yeah, they sought confidential treatment for a

1 lot of things and I believe included those.

2 Q And it wouldn't surprise you that Discover's president
3 came here and said that he believed that the particular fees
4 that it charges to merchants are confidential, competitively
5 sensitive information, would it?

6 A No, that wouldn't surprise me.

7 Q Do you, from your observation of the market, do you
8 agree, Professor, that many merchants are in fact unable to
9 determine what they're actually paying Visa and MasterCard for
10 particular transactions presented on particular cards?

11 A My understanding is there are merchants that have not
12 worked to figure that out. I'm surprised that they say they
13 literally couldn't do it because I would think they could go
14 to their acquirers and ask for an accounting of what it is
15 they're paying, but I'm aware that there are merchants that if
16 you ask them, they don't know what the number is.

17 Q And merchants have testified that when a consumer shows
18 up at their cash register and hands them a particular card,
19 Visa or MasterCard, they don't know what the rate there is
20 that they're going to pay to handle that transaction on that
21 particular card; you're aware of that, are you not?

22 A My recollection is that merchants have said that there
23 are systems you could do that do that, but that they don't
24 have them in place. So in general at the point of sale, they
25 don't know what the rate's going to be.

Katz - Cross / Chesler

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1 Q In fact, the testimony was that those systems don't yet
2 exist in the marketplace, wasn't it?

3 A I'm not aware of the testimony here. I believe I've read
4 elsewhere that there are ways you could do it, but.

5 Q You're familiar with the decree the government entered
6 into with Visa and MasterCard in connection with this case?

7 A You and I spent some time reading through it. I don't
8 know if I'd say familiar, but yes, I've seen it.

9 Q We spent some time at your deposition, right?

10 A Indeed we did.

11 Q There's nothing in that decree that requires Visa and
12 MasterCard to make their fee structures less complex than they
13 are now, is there?

14 A I don't believe there is.

15 Q In fact, there's nothing in the decree that would prevent
16 them from making their fee structures even more complex than
17 they are now, is there?

18 A That's my recollection, yes.

19 Q Did you read the testimony of the merchants who testified
20 from Southwest Airlines and Alaska Airlines?

21 A I certainly read portions of it.

22 Q Did you note in the testimony of the Southwest Airlines
23 employee whose name was Mr. Priebe that American Express's
24 merchant fees at Southwest went up and American Express's
25 volume of purchase at Southwest went down?

1 A I don't recall that.

2 Q Do you recall that the same thing took place at Alaska,
3 that is the testimony was American Express's rates went up,
4 American Express volume at Alaska Air went down?

5 A No.

6 Q Now, one of the things that you and I discussed at your
7 deposition about the decree, the decree being with Visa and
8 MasterCard and the government, that you assumed that under the
9 decree if American Express were to be subject to the same
10 rules, merchants would be able to steer from American Express
11 at the point of sale to a lower-cost card assuming that the
12 merchant could figure out whether it was a lower-cost card,
13 correct?

14 A Yes, if American -- well, if American Express was under
15 exactly the same decree, yes, American Express with some
16 merchants would be the able to enter into agreement so that it
17 wouldn't be possible, but certainly my interpretation of the
18 decree is that for most merchants, American Express would not
19 be able to stop that.

20 Q And under the decree, Visa and MasterCard can enter into
21 an agreement to pay a merchant to steer to them, correct?

22 A Yes.

23 Q I take it you would agree with me, sir, that you can't
24 get a consumer to be steered to you if the consumer doesn't
25 have your card, correct?

Katz - Cross / Chesler

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1 A Yes, I would agree with that.

2 Q And you would also agree that the vast majority of
3 American Express cardholders also have Visa and/or
4 MasterCards, correct?

5 A Yes.

6 Q But the vast majority of Visa and/or MasterCard
7 cardholders do not have American Express cards, correct?

8 A I believe that's correct.

9 Q So Visa and MasterCard could enter into agreements under
10 a decree with the government and pay merchants to steer
11 consumers, for example who show up with their American Express
12 Card, to steer to Visa and MasterCard, correct?

13 A Yes.

14 Q Now, if American Express were governed by those rules and
15 it were to pay merchants to steer to American Express from
16 Visa or MasterCard, that would only work if the Visa or
17 MasterCard consumer at the counter actually have an American
18 Express Card in her wallet, correct?

19 A In terms of steering from that to American Express, yes.

20 Q And you recall that I also asked you whether in the
21 but-for world that you considered here, if American Express
22 found itself in a situation in which it had an accepting
23 merchant that was actively steering its cardholders,
24 cardmembers away to a competing card, American Express could
25 not terminate those relationships and decide to walk away

1 rather than have its cardmembers steered; do you recall that?

2 A I recall having that general discussion, yes.

3 Q And that is your view, is it not?

4 A My view is that that's correct, subject to bounds on the
5 steering that the steering's not taking the form of
6 disparagement or some sort of mischaracterization, but, you
7 know, for example if the steering is some form of discount,
8 yes, my view is they could do it.

9 Q And that American Express could not just say 'look, if
10 that's what you're going to do, I choose not to have you as my
11 representative, I'm terminating,' American Express could not
12 do that, correct?

13 A In my but-for world, yes.

14 Q Now, do you agree that American Express is an important
15 competitive check on the exercise of market power by
16 MasterCard and Visa?

17 A Yes, that was certainly my opinion at the time of U.S. v.
18 Visa and it would be my opinion today.

19 Q In fact, it's an opinion you stated in one of your
20 reports in this case, correct?

21 A I don't know if I said it this time, but it is my
22 opinion, so.

23 Q Well, let's just for the record make sure we get it
24 clear.

25 Defendant's Exhibit 6507, which is your second

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1 report, it's in Volume 1, your rebuttal report. At page 78,
2 paragraph 148 you say: "Professors Bernheim, Gilbert and
3 Ordoover identify American Express as an important competitive
4 check on the exercise of market power by MasterCard and Visa
5 as discussed below. I agree with them on this point. Where
6 we disagree and where I believe their claims are at odds with
7 the facts is that they believe that merchant restraints
8 strengthen competition among American Express and rival credit
9 and chargecard networks."

10 Correct?

11 A Yes.

12 Q So is it still your view as expressed there?

13 A Yes.

14 Q And the fact of that competition from American Express
15 for Visa and MasterCard has important consumer benefits
16 associated with it, correct?

17 A Yes. Where here consumers being interpreted I -- well, I
18 would like to know how you mean consumer, just so I'm clear in
19 my answer.

20 Q I mean you and I, people who carry the card, get rewards,
21 use the card to buy things at merchants.

22 A You mean specifically American Express cardholders?

23 Q Yes. Well, yes. Let me ask the question again.

24 Does the fact that American Express presents
25 significant competition for Visa and MasterCard have important

1 consumer benefits, using consumer in the sense that I've just
2 given to you?

3 A Meaning important benefits for American Express
4 cardholders, I mean, the existence of American Express
5 certainly generates benefits for American Express cardholders,
6 yes.

7 Q And as we just talked about, most American Express
8 cardholders are also Visa and MasterCard cardholders, correct?

9 A Yes.

10 Q And it was concern that the possibility of rendering
11 American Express less able effectively to compete with Visa
12 and MasterCard that was a principal motivation for the
13 exclusionary rules case where you testified on behalf of the
14 government, correct?

15 A Yes. It was a concern that it was harming the competitor
16 process and that in that, that harm would manifest through the
17 effects on American Express and Discover's abilities to
18 compete.

19 Q So it wasn't the case of protecting American Express
20 there, it was a case of protecting competition, correct?

21 A Correct. Although Visa did not see it that way, I do
22 believe it was about protecting competition.

23 Q And in that case, in U.S. v. Visa, you testified that the
24 quality of offerings enjoyed by MasterCard and Visa
25 cardholders was driven to a significant degree by competition

1 from American Express and Discover, correct?

2 A I don't recall the specific thing, but I hold that view,
3 yes.

4 Q And in fact, you pointed to the fact that Visa had had
5 meetings, internal meetings, to determine how to improve their
6 Visa Gold Card because of competition posed by American
7 Express.

8 Do you recall that?

9 A I don't recall the specific example, but it's certainly
10 my view that American Express's premium cards have stimulated
11 efforts by MasterCard and Visa to respond.

12 Q And in fact, you noted that MasterCard's group called
13 Premium Card Strategy Council stated that American Express was
14 their primary competitive target and similarly that Visa tried
15 to develop a premium credit and chargecards that were aimed
16 directly at American Express.

17 Do you recall that?

18 A I don't recall that specifically, but certainly at the
19 time, American Express was a leader in premium cards and that
20 Visa and MasterCard were lagging and looked at American
21 Express as, you know, a place to -- a place to go
22 metaphorically, I guess.

23 MR. CHESLER: Your Honor, I'm about to go to a
24 somewhat different topic. Is this a good time?

25 THE COURT: Yes, it is. Let's take our ten minute

1 morning break now.

2 MR. CHESLER: Thank you, Your Honor.

3 (Recess taken.)

4 (Continued on following page.)

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Katz - Cross - Chesler

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1 THE COURT: Please be seated.

2 Mr. Chesler.

3 MR. CHESLER: Your Honor, I still believe I will, as
4 I said yesterday, finish by the lunch break. There's some
5 variance in that estimate, but I'm still -- as far as I can
6 tell, still on track.

7 THE COURT: Remind the witness you're still under
8 oath.

9 THE WITNESS: I understand, your Honor.

10 CROSS-EXAMINATION(CONTINUED)

11 BY MR. CHESLER:

12 Q Dr. Katz, I want to go back quickly on the topics we've
13 just been discussing recently. Recall I asked you about
14 whether Discover increased its rates during the period of the
15 American Express Recapture Program?

16 A Yes.

17 Q You're not aware of Discover being cancelled by my
18 merchants in connection with those rate increases, are you?

19 A I'm not aware. I didn't look into that. I'm not aware,
20 one way or the other.

21 Q A question about the consent decree we were talking
22 about. Remember I asked you about whether Visa and MasterCard
23 could pay merchants to steer to them; do you recall that?

24 A Yes.

25 Q It's also the case under the decree that a card network

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1 is not permitted to pay merchants not to steer away from this,
2 correct?

3 A I thought, in fact, it could do that in limited
4 circumstances, other -- under the decree, though. That's
5 not -- according to my recollection. I would be happy to look
6 at the decree, if you would like.

7 Q We may come back to that. You think that you can, in
8 fact, pay not to have consumers steered away from?

9 A I thought in some circumstances, yes.

10 Q All right. We may come back to the decree, and I'll ask
11 you about that. One other question on the topics we've
12 covered already, you talked about -- just before the break,
13 you talked about the other networks improving their Rewards
14 Programs; you thought was fair to say that that was in
15 response to competition presented by American Express. Do you
16 recall that?

17 A I thought I was saying they worked at having premium
18 cards and benefits associated with that, specifically,
19 improving Rewards Programs, but, yes, I recall the discussion
20 about premium cards.

21 Q Premium cards tend to have a higher level of rewards
22 associated with them, don't they?

23 A Yes.

24 Q And there are many, many more cardholders with Visa and
25 MasterCards than there are with American Express Cards,

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1 correct?

2 A Yes.

3 Q And to the extent that the competition you were talking
4 about before the break has caused an overall increase in the
5 rewards and benefits to the cardholders of those other
6 networks, those are benefits that are now possessed by many,
7 many more consumers in the market place than just those that
8 hold American Express Cards, correct?

9 A Yes.

10 Q So the topic I want to move to now is something called
11 tipping. You're familiar with the concept of tipping, are you
12 not?

13 A Yes, I note it's been used in some slightly different
14 ways. It's the same overall concept, but there's a range of
15 ways it's used. But, yes, I'm familiar with the overall
16 concept.

17 Q Why don't you describe to the Court what tipping is, as
18 you're familiar with it.

19 A So in markets with network effects, because there's this
20 benefit of being larger, that it makes you more attractive to
21 consumers, there can be a tendency that as a network gets
22 bigger it becomes a reenforcing process. It gets bigger; it
23 makes it more attractive, more people want it. It's then more
24 attractive still, and then more people want to join it after
25 that. So the most extreme form people talk about in economics

Katz - Cross - Chesler

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1 it tipping to a monopoly, where everyone piles on to the same
2 network.

3 Q And the corollary to that, I take it, is that a smaller
4 network could become smaller still as people pile onto the
5 dominant network, which would further reduce demand by the
6 cardholders and further reduce the attractiveness to
7 merchants, because of network effects?

8 A There are circumstances in which that could happen, yes.

9 Q And one of the things that you focused on in your
10 testimony in *U.S. V Visa* was that you thought one of the
11 benefits of getting rid of the exclusionary rules, and opening
12 up issuing banks to American Express and Discover, would be to
13 lessen the possibility of the market tipping to the dominant
14 networks, Visa and MasterCard, correct?

15 A Something like that sounds familiar, yes.

16 Q And one of the things you cited in connection with that
17 danger was that at the time American Express was about half
18 and Discover about one-quarter the size of MasterCard,
19 measured by the charge volume or number of transactions. Do
20 you recall using that metric?

21 A I'm sorry. I just didn't hear the last thing. Do I
22 recall using --

23 Q That metric?

24 A I believe I used several metrics, and that was one of
25 them.

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1 Q Let me ask you to look at your direct testimony in the
2 Visa case, DX733, we looked at before, and in particular page
3 176, paragraph 313. Do you have that, sir?

4 A Yes.

5 Q You can certainly look at the whole paragraph for a
6 moment before I ask you about it.

7 MR. CONRATH: Your Honor, I think this should not be
8 on the public screen, for the reason I said before. It's
9 under the protective order in the prior case.

10 MR. CHESLER: I apologize, your Honor. I should
11 have said that.

12 Q Have you had a chance to look at that, sir?

13 A Yes, I have.

14 Q So you're talking about some of the things that Professor
15 Pindyck had said; you were responding to him?

16 A Yes.

17 Q And you talk about the fact that he asserts network
18 effects make it difficult for a small system to survive
19 because of the danger of tipping, and then you have an
20 indented paragraph about tipping, correct?

21 A Yes.

22 Q And then toward the bottom of the paragraph, you say that
23 the value of multi-issuance, multi-issuance, meaning access to
24 multiple-issuing banks?

25 A I'm not sure, because it says -- it's related to that,

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1 clearly. The previous sentence, where it talks about duality,
2 helping MasterCard, I'm wondering what he -- giving issuer,
3 doing multiple brands, or whether he's talking about a given
4 network having multiple issuers. And it says --

5 multi-issuance is making me think -- because it's talking
6 about duality. It's talking about a single bank carrying
7 multiple brands of cards, is what I believe it's saying.

8 Q So a single bank issuing, for example, Visa Cards as well
9 as American Express Cards?

10 A Yes. And, in particular, Professor Pindyck was talking
11 about the bank doing MasterCard and Visa. And I was saying if
12 that argument is correct for MasterCard and Visa, it would
13 hold with even more strength, to the argument is correct, for
14 MasterCard and Discover being issued by the same bank as is
15 issuing Visa.

16 Q Thank you. In that context you say towards the end that
17 the value of this multi-issuance for strengthening competition
18 and preventing a downward spiral, should be even greater for
19 American Express and Discover, you say American Express is
20 approximately one-half the size of MasterCard measured by
21 charge volume or number of transactions, correct?

22 A Yes.

23 Q Now, at the time -- I think you said before you recall
24 that America Express' share of spend at that time was about
25 20 percent, correct?

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1 A Yes.

2 Q And MasterCard was about 25 percent at the time?

3 A Roughly. That's my recollection, yes.

4 Q So when you said here that American Express was
5 approximately one-half the size of MasterCard, you were
6 presumably referring to the metric of number of transactions,
7 correct?

8 A That number -- yeah, it looks like there's something
9 wrong with the sentence, because it would -- it says by charge
10 volume or number of transactions, and it was not half the size
11 by charge volume, so there's something wrong with the
12 sentence.

13 Q I was trying to make sure I understood. You couldn't
14 have meant American Express was half the size of MasterCard
15 based on charge volume; it was about four-fifths of the size
16 at the time, correct?

17 A Yes.

18 Q So to the extent you were emphasizing that this
19 multi-issuance would have particular significance for American
20 Express, given that it was about half the size of MasterCard,
21 you were presumably referring to the metric of number of
22 transactions?

23 A The half would -- or else the half was a mistake and was
24 supposed to be a different fraction referring to the volume.
25 The half does not correctly refer to volume; that's the safe

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1 statement.

2 Q Would you agree with me that as of today American Express
3 is still much smaller than MasterCard on the basis of number
4 of transactions?

5 A I believe that's correct. I'd have to look at the
6 numbers, but if you represent it is, I accept that.

7 Q You have no reason to doubt that it still lags way behind
8 MasterCard on number of transactions?

9 A It's a question of way behind, but my recollection is it
10 has a significantly smaller number of transactions.

11 Q Now, you recall co-authoring a paper with an economist by
12 the name of Carl Shapiro that dealt with systems competition
13 and network effects?

14 A We co-authorized a number of papers on that subject. We
15 also have one that has a title close to what you just said.

16 Q And Carl Shapiro is an economist who at one time had the
17 same position that you had at the Antitrust Division of the
18 Department of Justice, Chief Economist, correct?

19 A He had it two times, but yes.

20 Q In fact, he had it at the time this lawsuit was filed,
21 didn't he?

22 A I'm not sure -- around then. I'm not sure the date of
23 his tenure in that, but around then, yes.

24 Q I'd like you to look at Defendant's Exhibit 229, which is
25 in the second volume. I think it's the first document in the

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1 book. Do you have that, sir?

2 A Yes, I do.

3 Q And this appears to be an article entitled "Systems
4 Competition and Market Effect," Michael L. Katz, Carl Shapiro,
5 from the Journal of Economic Perspective, Spring 1994; is that
6 right?

7 A Yes.

8 Q And this is, in fact, one of the papers you've
9 co-authored with Professor Shapiro?

10 A Yes.

11 MR. CHESLER: Your Honor, I offer DX229.

12 MR. CONRATH: It's an out-of-court statement, but I
13 don't have an objection to this, your Honor.

14 THE COURT: DX229 is received in evidence.

15 (Defendants' Exhibit DX229 was received in
16 evidence.)

17 MR. CHESLER: Thank you, your Honor.

18 Q Would you turn to page 105, please.

19 A I'm there.

20 Q If you'd look at the paragraph that begins at the bottom
21 of page 105, you and Professor Shapiro state that in markets
22 with network effects -- we established this clearly, but just
23 to be clear, the payment market we're talking about is a
24 market with network effects, correct?

25 A That's correct.

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1 Q In markets with network effects, there is natural
2 tendency toward de facto standardization, which means everyone
3 using the same system. Because of the strong positive
4 feedback elements, systems markets are especially prone to
5 tipping, which is the tendency of one system to pull away from
6 its rivals in popularity once it has gained an initial edge.
7 And then you go on to say tipping has been observed in many
8 situations, including AM stereo radio, FM versus AM radio,
9 color versus black-and-white TV; and VHS versus Beta, and
10 video cassette recorder, typewriter keyboards, etcetera.

11 In the next paragraph you say consumer heterogeneity
12 and product differentiation tend to limit tipping and sustain
13 multiple networks. Do you agree with that statement, sir?

14 A Yes.

15 Q And would you agree that in the payments industry there
16 is product differentiation?

17 A Yes.

18 Q What did you -- what is meant when you say because of the
19 strong positive feedback elements, systems markets are
20 especially prone to tipping? What are positive feedback
21 elements?

22 A That was the process I was describing to the Court; that
23 network effect, the larger is the system the more benefit it
24 gives to a user from being part of that system, that then
25 could attract additional users, and that's in the positive

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1 feedback because those additional users can then make the
2 system still more attractive.

3 Q Would you also agree that when tipping of a market in
4 favor of one network in a multi-network market is likely,
5 exclusive dealing by that same network with individual
6 customers is more of a concern than if tipping were unlikely?

7 A I guess if that's the only difference, yes.

8 Q Would you also agree that a firm in a systems market has
9 strong incentives to build up consumer beliefs about its own
10 system and to tear down consumer beliefs about rival systems,
11 in an effort to tip the market in its favor?

12 A It certainly can, yes.

13 Q And, in fact, you and Professor Shapiro talked about that
14 situation in your article, did you not?

15 A Yes.

16 Q And you cited a couple examples of situations, real world
17 examples, where firms attempted to tear down consumer beliefs
18 about rivals and build up consumer beliefs about their own
19 systems, in an effort to tip the market in their favor. Do
20 you recall citing some examples of that?

21 A I recall citing one example that was in your opening
22 statement. We also -- yeah, I recall two.

23 Q And the one that I cite in my opening statement was
24 Visa's campaign of "Everywhere You Want To Be," whereas
25 merchants don't take American Express, you and Professor

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1 Shapiro cited that example as an example of this type of
2 attempt at tipping the market, correct?

3 A I misspoke. Because you made reference, I believe, in
4 your opening statement to a preference campaign, which this is
5 not, as I understand the term, but I inferred from that you
6 were characterizing this example. But, actually, I shouldn't
7 put words in your mouth. My view is the words that came from
8 your mouth don't match this example.

9 Q All right. Let's see if we can clarify that issue.
10 There are two different campaigns. One was "Everywhere You
11 Want To Be," and the other was "We Prefer Visa," correct?

12 A Whether they call them one campaign or another, I don't
13 know, but, here, we were talking about the particular
14 advertising of the "We Prefer Visa."

15 Q And, in fact, you know, do you not -- let me rephrase.
16 Do you know that a Mr. Morgan testified -- a former employee
17 of Visa testified at the trial?

18 A Yes.

19 Q And he testified about both the "Everywhere You Want To
20 Be" and the "We Prefer Visa" efforts. Do you recall that?

21 A I don't recall the testimony about the "Everywhere You
22 Want To Be."

23 Q So you don't recall that he, in fact, was shown documents
24 where Visa tracts the impact on perception of American Express
25 by consumers, and showed that the "We Prefer Visa" was even

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1 more impactful on American Express than "Everywhere You Want
2 To Be"? You're not aware of that?

3 A No. I wouldn't be surprised, but I'm not aware of it.

4 Q Okay. I won't take the time to show you Mr. Morgan's
5 testimony, it's already in the record, but I do want to -- I
6 want to ask you if you're aware of -- did you read the
7 testimony Mr. Morgan gave about his presentation to the Visa
8 Board in Cannes?

9 A No, I didn't read that testimony. I did hear that there
10 was a meeting in Cannes, but I didn't read that testimony.

11 Q Okay. It wouldn't surprise you, would it, Professor,
12 that Visa focused on the circle, the cycle, of using merchant
13 fees to fund rewards and other consumer benefits, so as to
14 make your value proposition to consumer more attractive and
15 thereby incent them to go to merchants and use your card? It
16 wouldn't surprise you that Visa was focusing on that cycle
17 that takes place in this two-sided market, would it?

18 A That's correct; it would not surprise me.

19 Q Would it surprise you that Visa focused in particularly
20 on its strategy of breaking that cycle for American Express by
21 focusing in on its fund supply for merchant fees?

22 A I could imagine Visa doing that. I don't recall seeing
23 documents to that, but I can imagine Visa having a strategy
24 like that.

25 Q You understand from your study of the industry that

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1 American Express began primarily -- didn't begin, but began
2 its card business primarily as a payment provider for travel
3 and entertainment merchants and business travelers who use
4 those merchants?

5 A Yes.

6 Q That was the niche, the niche in which it started, and
7 then it expanded over time to groceries, and supermarkets, and
8 just drugstores and so-called everyday spend?

9 A Yes.

10 Q So suppose the evidence here showed that Visa was
11 focussing in on breaking that cycle of American Expresses'
12 business model in order to push American Express back into
13 being just a niche provider, as opposed to a broad provider of
14 payment services across industries, suppose that was what the
15 evidence showed. Is it your view that that's procompetitive,
16 to push American Express back into being just a niche
17 provider?

18 A It would depend on how they did it? If they did it by
19 offering superior products that had greater appeal to
20 cardholders and to merchants, that would be a competitive
21 response; and that would be good for consumers, where
22 "consumers" is understood to be merchants and their customers.

23 Q And there are ways that they could have gone about doing
24 it which would be anticompetitive, aren't they?

25 A Yes, I would say that the exclusionary rules were one of

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1 the ways to do that, and I testified to that effect, that it
2 was to harm American Express and limit its ability to compete.

3 Q And if, in fact, there were anticompetitive ways not only
4 to choke off America Express' access to issuing banks, but to,
5 in fact, prevent American Express from obtaining funds for
6 merchant fees to fund its rewards program, that could be
7 anticompetitive as well, couldn't it?

8 A I can't rule it out as a general matter; it would depend
9 on the specific way they did it. But I believe, given enough
10 time, I could come up with a theory in which they were doing
11 bad things and they were anticompetitive rather than
12 competition on the merits.

13 Q And is it fair to say, sir, that you have not studied the
14 Visa Preference Campaign that Mr. Morgan was talking about?

15 A I'm not sure what, you're saying, the preference campaign
16 he's talking about. If you're asking me about "We Prefer
17 Visa," that campaign, do I consider that to be
18 anticompetitive, I do not.

19 Q My question was is it fair to say that you have not
20 studied that campaign?

21 A I guess there's a question of what you mean by "studied."
22 I looked at the documents available to me that described the
23 features. I've then reported those features in my reports and
24 reached a conclusion based on those facts.

25 Q Did you study the presentation that Mr. Morgan made to

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1 the Visa Board in Cannes?

2 A No.

3 Q Did you study Mr. Morgan's testimony about what their
4 intent was and how they went about it, as delivered in this
5 case?

6 A No, I did not look at evidence of their intent.

7 Q Thank you. Did you study the tracking studies that Visa
8 undertook to map the effects of their campaign?

9 A I certainly saw some evidence of -- the one to know is
10 whether the campaigns were effective and evidence that, in
11 fact, there was significant share shift, whether there was a
12 specific Visa tracking study, I don't recall. But certainly I
13 looked at evidence that share was shifted as a result of the
14 campaign.

15 Q Did you read Mr. Hochschild's, from Discover, testimony
16 that in connection with the we prefer campaign, Visa put
17 through price increases in its interchange rates and then
18 offered to reduce those price increases if the merchants would
19 participate in the Visa preference campaign?

20 MR. CONRATH: Objection. I believe that misstates
21 the prior testimony.

22 THE WITNESS: I did --

23 MR. CHESLER: I'm happy to show the witness the
24 testimony.

25 THE COURT: Why don't you do that.

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1 Q Let's look at Defendants' Exhibit 7766, please, which is
2 in Volume II. Do you have that exhibit, sir?

3 A Yes, I do.

4 Q Would you look at page 934, please. I'm happy to have
5 you look at any other context, and I'm sure if Counsel wants
6 me to direct you to others, he will. Let me ask you to look
7 at page 934, beginning at line five. Actually, beginning at
8 line seven. I'm asking a question, and I said:

9 "So this very good example, this very good example
10 that you cited was a situation in which Visa, if I understood
11 your testimony, was putting through price increases to
12 merchants and was saying we will roll back a portion of those
13 price increases if you agree that you will participate in the
14 Preferred Visa Campaign, correct?"

15 Answer: "Yes."

16 Question: "And you're saying that, in your view,
17 was a good example with the need for nondiscrimination
18 provisions, because it related to situations in which your
19 price was actually lower; your merchant price was lower than
20 Visa's, correct?"

21 Answer: "Yes."

22 So you see that Mr. Hochschild was talking about his
23 own nondiscrimination provisions in the context of Visa
24 putting through price increases to merchants and saying that
25 they would roll back a portion of those price increases if the

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1 merchant agreed to participate in the We Prefer Visa Campaign?

2 A Yes, I had read that testimony.

3 Q And do you remember other testimony that some merchants
4 described this as blackmail?

5 A That sounds familiar. I can't remember if it was in
6 testimony or deposition, but something to that effect, though.

7 Q And is it your view that this kind of tactic by Visa,
8 with its share of the market and its dominant position of
9 using rollbacks in price increases, to get merchants to
10 participate in the We Prefer Visa Campaign was procompetitive?

11 A Yes, offering discounts to merchants in order to get them
12 to express a preference can be procompetitive. It's
13 conceivable that taken to an extreme, it could become
14 exclusionary, but I believe it was procompetitive.

15 Q You believe -- and notwithstanding the characterization
16 by merchants it was blackmail, you believe it was
17 procompetitive, correct?

18 A Yes. As we've established from some of your earlier
19 questions, my concern is with competition not with the views
20 of particular merchants.

21 Q Right. And, then, we just let the chips fall where they
22 may, right?

23 A If the chips are falling where they may as a result of
24 increased competition, yes.

25 Q Now, if, in fact, a dominant network is able to tip the

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1 market through this type of tactic or others, can that be
2 anticompetitive?

3 A There are situations where it could be, yes.

4 Q If it, in fact, eliminates the competitive constraints
5 that are for the good of consumers, as a result of the market
6 tipping away from the smaller competitor in favor of the
7 larger competitor, that could have anticompetitive effects in
8 the market?

9 A Yes.

10 Q Just assume for purposes of my question -- indulge me for
11 a moment and assume Visa and MasterCard were able to tip this
12 market, as you reported with Professor Shapiro that at least
13 they tried to do at an earlier time --

14 A I'm sorry. I want to make sure you're not using tip now
15 in -- by tip now you just mean suppose they succeeded in
16 shifting some share to themselves?

17 Q No, I mean tipping in the sense that there is a kind of
18 run on the market, if you will; there's a tipping that moves
19 so much share to the dominant network that is successfully
20 tipping, that it actually diminishes in a material way the
21 ability of one or more smaller competitors to effectively
22 compete. That's a possible consequence of market tipping,
23 isn't it?

24 A Yes.

25 Q Suppose that happened, would we be left in that

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1 situation, effectively, with a duopoly in the payment market?

2 MR. CO RATH: I object that this is an incomplete
3 hypothetical.

4 THE COURT: I'll let the witness answer in whatever
5 way the witness wishes to answer.

6 THE WITNESS: No.

7 Q You do not believe that we would be left with a duopoly?

8 A If I understand your hypothetical correctly that American
9 Express and Discover would remain as competitors, so by
10 definition it wouldn't be a duopoly.

11 Q In order for it to be duopoly, they would have to be
12 entirely eliminated as competitors American Express, they,
13 meaning American Express and Discover?

14 A Duopoly means there are two suppliers.

15 Q You can have a monopoly in a market in which there are
16 other competitors, correct?

17 A The term is -- the economist using the term precisely
18 would say, no, a monopoly as you are the only supplier. We
19 can talk about situations where somebody has monopoly power
20 and act like a monopolist, as a shorthand, so it depends on
21 how you mean it. If you're asking me the question -- of what
22 your hypothetical is saying is we have two firms that are
23 stronger than others, and as part of your hypothetical the
24 other two were made weaker and that's diminished competition,
25 I'd certainly agree with that.

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1 Q Let's see if we can get on a common footing here. Are
2 you aware of situations in which companies have been found to
3 have monopoly power but the company is not the only competitor
4 in the defined market?

5 A Yes, just the same. The term is used that way.

6 Q Can you similarly conceive of situations in which two
7 firms are deemed to have duopoly power, but that doesn't mean
8 that there aren't some other competitors left in the market?

9 A Yeah, I'm not familiar with the term being used that way,
10 but sure.

11 Q If there were such a situation here, that is, where
12 American Express and Discover were left in the market but in
13 an effectively diminished -- substantially diminished capacity
14 as a result of tipping, would you expect the prices charged by
15 Visa and MasterCard to merchants to go up or down?

16 A I would expect the networks overall to keep more -- the
17 money for themselves. As a result of the harm to competition,
18 I would have to think about what it would mean for the fees to
19 networks, because, as I testified in *U.S. V Visa*, which is, in
20 some sense is the flip side of what you and I are talking
21 about, that it would be quite possible that increased
22 competition from American Express would raise interchange
23 rates; and, therefore, it logically follows a decreased
24 competition from American Express to lower interchange rates.
25 However, I think it would also be a harm to competition

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1 because the networks themselves would be keeping more money.
2 And, generally, the fact that this change was brought about by
3 a harm to competition would be a bad thing.

4 Q Okay.

5 THE COURT: You know, I don't have any problem with
6 these scenarios, but there are so many other factors. You
7 know, where is Senator Durbin in all this. You know, if you
8 have these kinds of seismic changes in the market place and
9 whether there would be some effort on the part of government
10 to influence the availability of -- or protect the rights of
11 consumers in this process? We just don't know. He came
12 riding up with the Durbin Amendment, and we are dealing with
13 that here, to some degree. So I'm little concerned that
14 while, you know, you're discussing factors that may actually
15 play out some day, I don't know, there may be other factors
16 that we're not even putting into the mix that could influence,
17 you know, where the market goes in the future.

18 So I just mention to you that anyone whose been
19 involved in how the government jumps into a situation, where
20 it has commerce clause power, I don't think that -- whatever
21 scenario you construct here, it's -- it's going to provide me
22 with a global understanding of what might happen. So I just
23 point that out to you so there be no mistake that -- I think
24 it's a more sophisticated exercise than just dealing with the
25 current players. But go ahead.

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1 MR. CHESLER: Thank you, your Honor. I appreciate
2 that.

3 Q Let me turn inform a subject that you mentioned on
4 direct, freeriding. Do you remember talking about that?

5 A Yes, I do.

6 Q And I think you defined freeriding as a situation where
7 somebody undertakes a costly action, and then somebody else
8 benefits from that action without having to pay for it,
9 correct?

10 A Yes.

11 Q And you testified yesterday, in substance -- you tell me
12 if I've correctly or incorrectly summarized this -- that you
13 did not think that merchants can freeride on America Express'
14 rewards because American Express incurred the liability for
15 that reward only when the card member actually uses his or her
16 card at the merchant, right?

17 A Well, I guess I would agree with that part of the
18 statement, but what I said was that when the cardholder uses
19 the rewards card at a merchant, the merchant then has to make
20 a payment to American Express and so that it's not freeriding.

21 Q And if the cardholder is steered to a different card, the
22 cardholder doesn't make a payment to American Express, right?

23 A Well, the cardholder doesn't make a payment to American
24 Express.

25 Q I misspoke. If the cardholder is steered to a different

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1 card, then the merchant doesn't make a payment to American
2 Express?

3 A That's correct.

4 Q Now, isn't it true, sir, that American Express incurred
5 certain expenses to provide customer service, marketing
6 innovating in its consumer programs which are incurred whether
7 or not a particular consumer uses her American Express Card to
8 complete a particular transaction?

9 A Yes.

10 Q And to the extent that any or all of those fixed costs
11 are incurred as an incentive to get the consumer to use her
12 American Express Card, and she is steered by the merchant to
13 use a different card, don't you agree that in that instance
14 the merchant is freeriding on America Express' fixed
15 investments?

16 A No.

17 Q And if, in fact, the consumer was brought into that store
18 because the store identified itself as an accepting American
19 Express merchant and she came in with the intent to make a
20 purchase, perhaps higher than average purchase for that
21 merchant with her American Express Card, and is then steered
22 to Visa, you also think that is not freeriding, correct?

23 A Yes, for a different reason. But, yes.

24 Q Let me go to a different subject. I think we've
25 established that there are several million merchant locations

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1 in the United States that accept Visa and MasterCard and not
2 American Express Cards, correct?

3 A Yes.

4 Q And I think there's some -- I asked you at your
5 deposition whether you thought that that number was on the
6 order of 3 or 4 million locations, and you agreed with that.
7 You still think that's a fair estimate?

8 A Yes. I think you asked me earlier today, and I said --
9 the same question. Or you asked me about 3 million and that
10 seems about right, yes.

11 Q I think I asked that in the context of Discover but I'm
12 asking now --

13 A Discover's quite close. In any case, yes, that sounds
14 about right.

15 Q Okay. Now, as a result of the Consent Decree between the
16 government, and Visa and MasterCard, at those 3 or 4 million
17 merchants locations, whatever the number is, those are
18 merchants that are not subject to the previous non-steering or
19 nondiscrimination provisions of Visa and MasterCard, correct?

20 A That's correct.

21 Q Now, many of those merchants also accept Discover, right?

22 A Yes.

23 Q And so they may or may not be subject to Discover's
24 provisions, correct?

25 A That's correct.

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1 Q But, in any event, they're not subject to America
2 Express' provisions because American Express is not accepted
3 at those merchants?

4 A Yes, by definition.

5 Q Now, at your deposition, I asked you about Discover's
6 nondiscrimination rules, and you pointed out that you thought
7 that a witness from Discover had said that its rules were
8 different, and they were in force in a different way from
9 America Express'. Do you recall that?

10 A I recall the general discussion, yes.

11 Q And you also said that when you had read the rules
12 yourself, you thought that the rules were consistent with that
13 witness' testimony, that the Discover rules were different
14 from the American Express rules. Do you recall that?

15 A No, I don't.

16 Q Okay. Let me ask you to look at your deposition, page
17 329. So this would be in Volume I. I think it's the second
18 day of your deposition. Do you have it, sir?

19 A Yes, I do.

20 Q So beginning at line three I ask, "Oh, so --"

21 A I'm sorry. Maybe I misheard you. I didn't hear the page
22 number.

23 Q 329.

24 A Sorry. Okay. I'm now on page 329.

25 Q Beginning at line three, I ask, "Oh, so you did read them

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1 trying to determine whether they, in your view, were different
2 from what he said they were?" I'm referring there, "them" as
3 Discover's rules, and "he" is the Discover witness who turns
4 out to be Mr. Hochschild. And you said, "Yes." Then I said,
5 "Okay. And you concluded they were consistent with what he
6 said?" "Yes."

7 Question: "So then you believe, having read the
8 rules, that they are different from America Express' rules?"

9 Answer: "Yes. I just want to be clear that that's
10 not what I believe you asked me before, so if I misunderstood
11 your earlier question, I apologize. But I believe you asked
12 me a question about reading them, holding aside whatever the
13 witness said."

14 And then I said, "All right. In any event, you read
15 them, and your view, having read the rules, is they are
16 different from America Express' rules." There was an
17 objection. And then you said, "As I've said, the Discover
18 witness said that the rules were different, and they were in
19 force in a different way. When I read the rules, I thought it
20 was consistent with the witness' testimony. Some of the
21 testimony is not about what's in the four corners of the
22 contract, it has to do -- well, arguably, I guess, everything
23 is in it, but it's about how he testified Discover interprets
24 its rules and enforces them."

25 Do you believe that the actual text of the Discover

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1 rules show that they're different from America Express', that
2 they're enforced in a different way?

3 A I don't recall specifically what the rules say, but from
4 reading my deposition testimony, I don't believe that my view
5 about their enforcement was based on the rules themselves, but
6 instead it was based on Mr. Hochschild's deposition testimony.

7 Q Okay. Do you have an understanding of whether Discover
8 is enforcing its nondiscrimination rules at the 3 or 4 million
9 merchant locations that today accept Discover, Visa,
10 MasterCard but not American Express?

11 A I believe it was testified to at trial that they
12 haven't -- I have to be careful about using the word
13 "enforcement." That they haven't brought an action against
14 anybody, if I'm remembering correctly, but I think they're
15 enforcing the rule, if they have it, but -- that's my belief.
16 But I can't -- as I sit here, I'm not sure I saw something
17 saying specifically whether they're enforcing the rule or not.

18 Q Do you think that Discover, a merchant which accepts
19 Visa, MasterCard and Discover but not American Express, that
20 Discover can effectively enforce its nondiscrimination rules
21 to prevent the merchant from steering?

22 A It would depend on the circumstance. In particular,
23 circumstances where we have Discover, Visa and MasterCard
24 pricing close together, yes, that the merchants will agree to
25 the rules. Now, if the merchant had some strong reason to

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1 steer, it's my testimony that, then, it would be difficult for
2 Discover to maintain its rule.

3 Q And why would it be difficult for Discover to maintain
4 its rule?

5 A Because of its -- the small share it has with the
6 merchants, relative to the other ones, that if someone wanted
7 to steer, say, between MasterCard or Visa because there was a
8 significant difference between the two, that -- the potential
9 of benefits of steering would be large relative to the costs
10 that would be incurred by no longer accepting Discover.

11 Q So it would be a function of the small share that
12 Discover has at a particular merchant?

13 A Relative to the shares of the networks between which the
14 merchant was seeking to steer, yes.

15 Q And in many merchants, Discover has like a single-digit
16 share of the spend of the merchant, correct?

17 A Yes.

18 Q And that's true of American Express, isn't it; aren't
19 there many, many merchants, particularly in the everyday spend
20 category, where American Express' share of spend is low single
21 digits?

22 A I would -- could well be, especially by merchant count,
23 yes.

24 Q And so by force of logic, wouldn't you agree that if
25 Discover was unable to enforce its steering rules at that

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1 those merchants, American Express would similarly be unable to
2 enforce its steering rules where it had 3, 4, 5 percent of
3 spend?

4 A In the presence of large differentials, in the rates, it
5 gave the merchants incentive to steer otherwise, yes.

6 THE COURT: Are we going to have testimony on your
7 case about how American Express enforces its
8 antidiscrimination provision with small merchants?

9 MR. CHESLER: I believe so, your Honor. I think
10 there's been some --

11 THE COURT: There's been some.

12 MR. CHESLER: -- already.

13 THE COURT: But more focused. Since you raised that
14 issue with this witness, I'd like to know more about it.

15 MR. CHESLER: Thank you, your Honor. We'll
16 certainly do that.

17 Q Have you done any study of the number of merchants at
18 which American Express has, in fact, a single-digit share, as
19 compared to much larger shares by Visa and MasterCard of the
20 spend?

21 A I don't believe I have.

22 Q Now, you agree, do you not, that merchant resistance
23 could be expected to induce the Discover network to drop its
24 restrictions on steering and discounts if America Express'
25 merchant restraints were no longer in effect?

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1 A Yes, it certainly could happen.

2 Q And at the 3 or 4 million merchant locations that don't
3 accept American Express, America Express' provisions are not
4 in effect by definition, correct?

5 A Yes.

6 Q Now, you're not aware of any evidence, are you, to
7 suggest that in the year since the Consent Decree went into
8 effect, Discover has experienced any significant level of
9 cancellations at the merchants that accept its card, as well
10 as Visa and MasterCard, but not American Express?

11 A That's correct; I'm not aware of the evidence.

12 Q Are you aware, sir, that when the government entered into
13 its Consent Decree with Visa and MasterCard, it filed
14 Competitive Impact Statement with this Court?

15 A Yes.

16 Q And have you reviewed that at some point? Have you read
17 it?

18 A I believe I've read some of the paragraphs. I don't
19 think I've read the whole thing.

20 Q Are you familiar with the statement in the Competitive
21 Impact Statement that merchants that currently accept only
22 Visa, or MasterCard or both will benefit immediately from the
23 final judgment by having the freedom to encourage their
24 customers to choose the merchant's preferred method of
25 payment?

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1 A I don't recall reading that.

2 Q May I ask you to look at Defendants' Exhibit 7580,
3 please. It's in Volume II. Do you have that?

4 A Yes, I do.

5 Q You see this is the Competitive Impact Statement filed by
6 the United States --

7 A Yes.

8 Q -- in this case?

9 A Yes.

10 Q Would you turn to page 14, please? You see the paragraph
11 at the top of page 14 starts with the sentence I just read to
12 you. Merchants that currently accept only Visa, or MasterCard
13 or both will benefit immediately from the final judgment by
14 having the freedom to encourage their customers to choose the
15 merchant's preferred method of payment. And it goes on to
16 talk about several new options that would be available to
17 accomplish this. Do you see that, sir?

18 A Yes.

19 Q And, in fact, the government held a press conference on
20 the day that it announced the settlement, did it not?

21 A I would expect that they did.

22 Q And made a similar statement, then, that the 4 million
23 merchants across the U.S. that only accept MasterCard and
24 Visa, that their customers should begin to seek immediate
25 results because immediately the restrictions are lifted on

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1 those merchants to begin to compete for those consumer
2 dollars?

3 A I believe, your now current partner, I saw something to
4 the effect that she said that. I was shown separately from
5 the press conference, but that sounds familiar.

6 Q This was then Assistant Attorney General Varney?

7 A Yes.

8 Q Now, in fact, Discover's president testified that at
9 those merchants, as far as he knows, the merchant fees have
10 increased since the Consent Decree went into effect?

11 A I don't recall his testimony on that.

12 Q Does it surprise you that that would be the case?

13 A No.

14 Q Now, you address some proposed explanations for why the
15 immediate effects that the government predicted have not come
16 about. Do you recall doing that in your report, your
17 surrebuttal report?

18 A I recall talking about reasons that, when you look at
19 merchants that don't take American Express, why you would see
20 what you see. I don't recall whether I addressed specifically
21 what's here, which is talking about merchants that take Visa
22 and MasterCard and nothing else, but their arguments would be
23 relevant to that.

24 Q So let me ask you to look at Defendants' Exhibit 6540,
25 which is your surrebuttal report. That's in Volume I,

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1 beginning at paragraph 551. I believe that's page 313.

2 A Yes.

3 Q And you have a heading there. It says "Merchants that
4 don't accept American Express today." Do you see that?

5 A Yes.

6 Q And you talk about, in 551, Dr. Gilbert, Richard Gilbert,
7 observing that many merchants accept Discover, MasterCard and
8 Visa but do not offer discounts; and that Dr. Bernheim makes a
9 related argument, and, specifically, he asserts that the
10 merchant restraints must not be anticompetitive because
11 merchants that do not accept American Express Cards have not
12 received systematic reductions in interchange fees, following
13 the Consent Decree entered into by MasterCard and Visa. And
14 you then say there were several reasons why Dr. Bernheim's and
15 Gilbert's arguments are unpersuasive and invalid, correct?

16 A Yes.

17 Q And you then go on to recite what those arguments are?

18 A Yes.

19 Q So one argument which you assert in paragraph 552 is that
20 it is not clear to which networks Doctors Bernheim and Gilbert
21 believe steering should occur. Weighted by charge volume,
22 American Express, generally, but not always is the highest
23 cost network, while other networks tend to be comparably
24 priced; hence, the merchant generally has much less incentive
25 to engage in steering if American Express is not one of the

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1 credit and charge card networks that the merchant accepts.

2 That's the argument you made there?

3 A Yes.

4 Q Now, if one of the cards of the three that the merchant
5 accepts is cheaper to the merchant than the other two, would
6 you agree that the merchant had the opportunity to save money
7 if it steers to whatever that cheapest card is of that
8 merchant?

9 A It would depend on the cost of steering, but there's a
10 potential benefit from the steering if one is cheaper than the
11 other and the steering is successful.

12 Q And it's not your opinion that merchants are satisfied
13 with the rates that they're currently paying to Visa,
14 MasterCard, Discover today, right?

15 A That's correct.

16 Q So, in fact, if merchants are not satisfied with the
17 current rates and they were free to steer because American
18 Express is not present at that merchant, then they would have
19 an incentive to steer, in an effort to cause a lowering of the
20 rates by one or more of the networks whose cards they accept,
21 right?

22 A That would depend on the merchant. If you're a small
23 merchant, MasterCard and Visa do not bargain with you; they
24 literally represent the -- my understanding is they literally
25 won't talk to you if you're a small merchant. So, in fact,

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1 you can't engage in bargaining and you can't say to a network,
2 well, if you don't lower your price, we're going to steer to
3 somebody else, so it would depend on the merchant involved.

4 Q And there's nothing in your but-for world that says that
5 Visa and MasterCard networks would have to talk to the
6 merchants then, just as they're not talking to them now?

7 A To the small ones, yes, that's correct.

8 Q The small ones, as we discussed before, \$500,000 or less,
9 that's 98 percent of America Express' current merchants,
10 right?

11 A That's what you had said earlier, and I'll accept that
12 representation.

13 Q And do you agree that even where the networks have their
14 prices fairly closely clustered together, Visa, MasterCard and
15 Discover, that merchants could use steering to get competition
16 moving, and that would be of a benefit?

17 A Again, it would depend on the merchant, whether an
18 individual merchant would have the ability to do that. If
19 you're talking about a large merchant that's engaged in
20 individual bargaining, then it's a possibility. If you're
21 talking about a small merchant that just takes the prices
22 given, that individual merchant, essentially, has very little,
23 if anything, that it can do.

24 Q So for all of those merchants, then, steering would have
25 no benefit; is that your testimony?

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1 A No, if it were allowed completely and -- one of the
2 things we have to add into this, if you're thinking about
3 having a network initiative, at this point, applying it to
4 small merchants, my understanding is that Visa, MasterCard and
5 Discover would not know which merchants take American Express
6 and which don't, so it would be hard-pressed to figure out
7 where their initiative applied. So that's a situation that
8 would change. If no one had the rule, then you would always
9 know that you had the initiative, that steering could be
10 possible; and that would then change a network's incentive to
11 engage in practices that could lower prices, for example, that
12 could then create incentives for steering.

13 Q If Visa and MasterCard know that a particular merchant
14 doesn't accept American Express and, therefore, that that
15 merchant is not subject to American Express' provisions, and
16 Visa and MasterCard have agreed not to enforce their
17 provisions, does Visa -- do Visa and MasterCard have any
18 incentive to lower their rates to that merchant?

19 A We're talking about a large merchant or small one?

20 Q I didn't qualify it by size.

21 A Okay. If it's a small merchant, I think they would have
22 very little incentive.

23 Q That's true now, and it would be true in your but-for
24 world, correct?

25 A At the level thinking about an individual merchant, yes.

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1 Q Do you know how much purchase volume is represented by
2 the 3 or 4 million merchant locations that accept Visa,
3 MasterCard and, perhaps, Discover but not American Express?

4 A No.

5 Q Have you made any effort to determine how much it is?

6 A I don't believe I have.

7 Q If I told you that it could be as much as 3- to
8 \$400 billion every year, would that surprise you?

9 A No.

10 Q You mentioned Australia briefly in your testimony, if
11 it's 3- or \$400 billion a year of spend volume that the
12 merchants that don't accept American Express, do you know
13 that's about the size of the Australian economy?

14 A No, I don't know that, but I'll accept your reputation.

15 Q Can the networks -- meaning Visa and MasterCard, could
16 they simply publish different rates for merchants that do
17 accept American Express and merchants that don't?

18 A If you're asking do they have the technical ability to do
19 it, yes; that's something I have thought about and wonder what
20 the reaction would be in terms of potential antitrust action,
21 but I believe they could do it. Certainly have the ability to
22 do it physically.

23 Q So to your knowledge they aren't done that with respect
24 to the merchants in the post-Consent Decree world who don't
25 accept American Express, have they?

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1 A I don't believe that they have identified separate rates
2 for merchants that do and don't accept American Express.

3 Q You also said in paragraph 554 of your surrebuttal report
4 that there may be a lack of steering of merchants that do not
5 accept American Express today, because these merchants are
6 slow to adapt to changes and/or want other merchants to test
7 the waters. Do you see that, sir?

8 A Yes.

9 Q The decree's been in effect for more than three years,
10 right?

11 A I guess at this point that's correct.

12 Q And you've testified that a period of at least a year
13 should be a sufficient amount of time to see changes resulting
14 from the removal of restrictions on steering, if such steering
15 were going to occur, haven't you?

16 A I don't recall saying that, but I expect to see some
17 merchants do some steering over that time period, if there
18 were significant incentives to do so.

19 Q And, in fact, in connection with the Durbin Amendment,
20 haven't you testified that not observing steering after a
21 period of a year or longer suggests that it's not going to
22 take place?

23 A I certainly thought that there wasn't steering during
24 that period; that right now is confirming the fact that that's
25 different to steer that way, yes.

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1 Q When you read Mr. Hochschild's testimony, did you read
2 his testimony about forming a task force to look at the
3 hundred largest merchants?

4 A I remember parts in his testimony, things where he talked
5 about reaching out to large merchants. I'm not sure I
6 remember the specific task force you're talking about.

7 Q I'll leave that, because it's in the record.

8 I think you said this before. I just want to
9 confirm it. You're aware, with respect to the large
10 merchants, American Express, in fact, negotiates its
11 acceptance agreements?

12 A Yes.

13 Q Including customizing, in many instances, the
14 nondiscrimination provisions?

15 A I think we may run into question of terminology or what
16 the scope of what you call the nondiscrimination provisions, I
17 was calling them merchant restraints, and now have been
18 calling to be neutral. I started -- forgot what I started
19 calling them. But I'm not sure -- I'd have to see where the
20 particular parts are. I'm aware that American Express
21 negotiates various things, allowing steering with co-brands.
22 I just can't remember if that's within the four corners of the
23 text that the complaint identifies as the rules. But I am
24 certainly aware that there are forms of steering that American
25 Express allows.

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1 Q With respect to the government statement to the Court in
2 its Competitive Impact Statement and the statement at the
3 press conference that consumers would see immediate benefits
4 at the 3- or 4 million merchant locations that do not accept
5 American Express Cards, that has turned out to be inaccurate,
6 hasn't it?

7 A One thing, the statement -- the one thing you showed me,
8 actually, did not say -- it says the ones that accept -- only
9 Visa and MasterCard or both, which I believe is, actually, a
10 few hundred thousand merchants.

11 Q Are you aware of any immediate impact for consumers at
12 those merchants since the Consent Decree went into effect?

13 A No.

14 Q And, in fact, what Assistant Attorney General Varney said
15 at the press conference, she referred to 4 million merchants
16 that were going to see immediate effects?

17 A I don't recall, but if that's what you say she said,
18 obviously I have no reason to doubt that.

19 THE COURT: She's your partner.

20 MR. CHESLER: Indeed, she is, your Honor. She
21 became partner of our law firm when she left government
22 service.

23 THE COURT: Did you ask her?

24 MR. CHESLER: I'm not allowed to speak to her about
25 this case, your Honor.

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1 THE COURT: Good thing.

2 MR. CHESLER: Literally not allowed.

3 THE COURT: Yes, I understand. Just checking.

4 MR. CHESLER: Is Mr. Gold here? I need my counsel.

5 Q Assuming she referred to 4 million merchants, where there
6 would be immediate benefits for consumers, that would have to
7 include the merchants that accept Discover as well as Visa and
8 MasterCard but not American Express?

9 A I would think so.

10 Q So with respect to that statement, the immediate effects
11 that were predicted, so far as you know, have not occurred; is
12 that fair?

13 A That's correct.

14 MR. CHESLER: Two other things, your Honor, and then
15 I'll be done.

16 THE COURT: Okay.

17 MR. CHESLER: Do we have a copy of the decree that I
18 can show the witness? Is it in the book. It's in the binder.

19 Q DX5828, please.

20 A This is in Volume II.

21 Q It's in Volume II. 5828. Do you have that?

22 A Yes, I do.

23 Q All right. I'd like you to turn to Section Capital B,
24 which begins on page seven.

25 A I'm there.

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1 Q And just for context, on page 5, theres a Roman Numeral
2 VI called "Prohibited Conduct" that as a Section Capital A
3 that begins on 5 and runs over to the top of page 7. And then
4 Section Capital B begins. Do you see that, sir?

5 A Yes.

6 Q Okay. So Capital B says subject to compliance with the
7 antitrust laws that Dodd Frank Wall Street Reform and Consumer
8 Protection Act of 2010 and any other applicable state or
9 federal law, nothing in this final judgment shall prohibit
10 MasterCard or Visa from -- and then there are numbered
11 paragraphs which explain what they're not prohibited from
12 doing, correct?

13 A That is correct.

14 Q All right. So let's go down to subparagraph three. So
15 nothing in the judgment shall prohibit them from -- paragraph
16 three -- enforcing existing agreements or entering into
17 agreements pursuant to which a merchant agrees -- and then
18 little sub (i), that it will encourage customers through
19 practices enumerated in other sections of the judgment to use
20 general purpose cards bearing the defendant's brand as payment
21 for goods and services. So let's stop there.

22 So with would you agree that nothing in the judgment
23 prohibits MasterCard or Visa from enforcing agreements or
24 entering into agreements in which the merchant agrees that it
25 will steer customers to them, to Visa and MasterCard?

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1 A Yes, subject to the rest of the paragraph, but, yes,
2 that's what the first part says.

3 Q Okay. And, then, sub (i)(2) says nothing in the judgment
4 shall prohibit MasterCard or Visa from enforcing existing
5 agreements or entering into agreements, pursuant to which a
6 merchant agrees that it will not use one or more practices
7 enumerated elsewhere in the judgment, to encourage customers
8 to use general purpose cards bearing any other person's brand
9 as payments -- payment for good and service. And then there
10 are some provisos, right?

11 A Yes.

12 Q What is your understanding of sub (2)(i)?

13 A That in the circumstances that -- it's looking at things
14 as a pair; that, one, is saying here are the things you can do
15 to encourage the use. And, then, two is saying and that when
16 you're doing that, you can also have as part of the agreement
17 that you won't do those things to steer to another brand,
18 subject to the later proviso.

19 Q Okay. So do you have an understanding of whether Visa
20 and MasterCard can pay merchants not to steer away from them,
21 as opposed to paying a merchant to steer to them?

22 A On a limited -- I thought they have this thing -- they
23 have some part talking about some steering to them and some
24 away. I guess in the extreme form, yes, it would suggest that
25 they could have payments not to steer away from them on the

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1 limited basis identified by the rest, yes.

2 Q And not otherwise?

3 A I'm sorry?

4 Q And not otherwise, other than the limited basis that's
5 stated here?

6 A I -- well, this basis states what the limit is on how
7 much they're allowed to do it, subject to that limit.

8 Q Okay. Just ask you quickly about Australia, because it
9 came up, I think, in colloquy with the Court yesterday.

10 Australia is a situation where the national bank,
11 the reserve bank, issued regulations relating to merchant
12 surcharging, correct?

13 A That's correct.

14 Q So it was not an antitrust enforcement case by their
15 antitrust division, if there is one, it was a government
16 regulation that instituted merchant surcharging there,
17 correct?

18 A That's right. The antitrust would have been the ACCC,
19 which, I think, commented in the proceeding, but it was a
20 regulatory proceeding.

21 Q Now, are you familiar a report that was issued by the
22 United States GAO, the Government Accountability Office, that
23 looked at and made comments about the reserve Bank of
24 Australia regulations?

25 A I don't recall that. I may have seen it, but as I sit

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1 here, I don't recall that.

2 Q Let me ask you to look at Defendants' Exhibit 3994.

3 MR. CHESLER: This one, your Honor, was not in the
4 book because we didn't anticipate this question coming up.
5 We're going to hand it up.

6 THE WITNESS: You can answer for me. Thank you.

7 Q 3994?

8 A Yes.

9 Q You recognize this as a report of the GAO on credit and
10 debit cards?

11 A Yes.

12 Q It's dated, apparently, May 2008 in the upper left-hand
13 corner. Do you see that?

14 A Yes.

15 Q Let me ask you to --

16 MR. CHESLER: Just need to find the reference,
17 your Honor. Just give me a moment. I'm sorry, your Honor,
18 can we just have a moment?

19 THE COURT: That's fine. You're doing pretty good.

20 MR. CHESLER: Thank you.

21 (Pause in proceedings.)

22 THE WITNESS: I guess you're going to be looking in
23 the 30s.

24 MR. CHESLER: Sorry, your Honor, it should be 7202.
25 I apologize, your Honor, turns out there were two GAO reports,

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1 both in May of 2008. Got the wrong one.

2 THE WITNESS: I have two copies of -- certainly from
3 the cover page and the numbering, they appear to be the same
4 report because they're both GA008558.

5 MR. CHESLER: May I approach the witness,
6 your Honor?

7 THE COURT: Sure.

8 THE WITNESS: They have different exhibit numbers,
9 but the GAO numbers are the same.

10 Q Okay. So the record is clear, I have now handed you a
11 copy of 7202, Defendants' 7202. Do you have that?

12 A I'm sorry. Can I just ask -- it's quite odd that there
13 would be two reports from the GAO with the same number. Can
14 you tell me what the difference is?

15 Q I see that they have the same number, and I don't know is
16 the answer.

17 A Perhaps they didn't have someone remind them of a number
18 that had already been used.

19 Q Maybe.

20 MR. CONRATH: For what it's worth, your Honor, they
21 look to me to be two different DX numbers.

22 MR. CHESLER: No, they're not. They're not the same
23 document. But I have to say I don't know why.

24 THE COURT: All right. Let's move on.

25 Q If you look at the second page of 7202, it's a page

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1 entitled "Credit and debit cards. Federal entities are taking
2 actions to limit their interchange fees, but additional
3 revenue collection cost savings may exist." Do you have that
4 page, sir?

5 A Yes.

6 Q Okay. Down in the middle of that page, there's a
7 paragraph, second paragraph, under the heading "What GAO
8 found." Do you have that?

9 A Yes.

10 Q It says several countries have taken steps to lower
11 interchange rates, but information on their effects is
12 limited. Among the three countries GAO examined, regulators
13 in Australia and Israel intervene directly to establish limits
14 on interchange change rates, while Mexico's banking
15 association voluntarily lowered some rates. Since Australia's
16 regulators acted in 2003, total merchant discount fees paid by
17 merchants have declined, but no conclusive evidence exists
18 that lower interchange fees led merchants to reduce retail
19 prices for goods. Further, some costs for card users, such as
20 annual and other fees, have increased.

21 Then it goes on to talk about Mexico and Israel. Do
22 you see that, sir?

23 A Yes, I do.

24 Q Do you have any reason to doubt the GAO's findings as of
25 May 2008?

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1 A No.

2 Q And, in fact, sir, you understand that in the Australian
3 case, the Visa and MasterCard interchange fees were capped by
4 the regulations, correct?

5 A That's my recollection. They were regulated and limited
6 in some way.

7 Q There's something no the Consent Decree between the
8 Department of Justice, and Visa and MasterCard that caps their
9 fees, is there?

10 A Not that I recall ever seeing.

11 MR. CHESLER: Your Honor, I have no further
12 questions.

13 Your Honor, before I step away, I'm told that figure
14 six from Dr. Katz' first report, which is Defendants'
15 Exhibit 6466, that I should be identifying that as 6466A,
16 offered just for illustrative purposes, and that I
17 neglected --

18 THE COURT: That's table -- which table?

19 MR. CHESLER: Figure six, from Defendants' 646. And
20 also table 22, which I referred the witness to from the same
21 exhibit, we would offer that as 6466B, for illustrative
22 purposes only.

23 THE COURT: Any objection?

24 MR. CONRATH: No. But if I could have a moment to
25 get the proper references?

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1 MR. CHESLER: Figure 6 and table 22. Table 22 is B.

2 MR. CONRATH: 6266B. No objection. Demonstrative.

3 THE COURT: DX6466A and DX6646B are received in
4 evidence as demonstrative exhibits.

5 (Defendants' Exhibit DX6466A and DX6466B were
6 received in evidence.)

7 REDIRECT EXAMINATION

8 BY MR. CONRATH:

9 Q Good afternoon, Dr. Katz.

10 A Good afternoon.

11 Q Could I begin by asking you to turn to your article in
12 the Journal of Economic Perspective with Dr. Shapiro, which I
13 believe is DX0229?

14 A Yes.

15 Q So could I ask you to turn to page 107 of Exhibit 0229,
16 please?

17 A Yes.

18 Q So I'm going to direct -- do you recall some questions
19 from counsel for American Express about this is the tipping
20 article?

21 A Yes.

22 Q And some questions specifically about the references to
23 Visa here?

24 A Yes.

25 Q I just would like to be clear about what you were talking

1 about here, so could we look at on page 107, the paragraph
2 second from the bottom that begins more generally. And
3 this -- I believe that you were read this first sentence, but
4 I like to focus your attention on the last sentence in this
5 paragraph that talk about what Visa activities you were
6 discussing here.

7 Does it read: "And Visa has had a long-running
8 advertising telling consumers that Visa cards are accepted
9 quote, "Everywhere You Want To Be," closed quote, whereas
10 merchants, quote, "Don't take American Express," closed quote?

11 Did I read that right?

12 A Actually, I thought you missed a word, but, yes.

13 Q All right. And so when you were talking about the
14 possibility of tipping in connection with Visa, were you
15 discussing the part of this advertisement that talks about
16 don't take American Express, and they don't take American
17 Express?

18 A You're talking about both parts. It's the point that you
19 want consumers to be aware that you have a large network; and
20 to the extent that your competitors have smaller networks, you
21 also want consumers to be aware of that, so it's referring to
22 both parts.

23 Q And you were not discussing Visa Preference or We Prefer
24 Campaign; is that right?

25 A No, this was a different thing. The preference

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1 relationships are with merchants, and this is about the
2 advertising that Visas doing as a network.

3 Q As far as you understand, the American Express
4 anti-steering rules don't have anything to do with whether
5 Visa can or cannot run advertising campaigns?

6 A I don't see how they could.

7 Q Could you turn to the previous page, please, of DX0229.
8 I'd like to direct you to the first full paragraph on that
9 page that begins "consumer heterogeneity." Do you see that?

10 A Yes.

11 Q So counsel read you the first sentence here, which I will
12 read again. "Consumer heterogeneity and product
13 differentiation tend to limit tipping and sustain multiple
14 networks." And I'm going to go on to read the next sentence.

15 "If the rival systems have distinct features sought
16 by certain consumers, two or more systems may be able to
17 survive by catering to consumers who care more about product
18 attributes than network size."

19 Did I read that correctly?

20 A I believe you did.

21 Q So is the credit card networks' market one in which rival
22 systems have distinct features sought by certain consumers?

23 A Yes. The networks do, and the cards that they provide a
24 gateway to differ, yes.

25 Q Is the credit card networks' industry one in which

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1 merchants can use more than one credit card network?

2 A Yes, it's quite typical for a merchant to accept multiple
3 networks, credit and charge cards.

4 Q So one doesn't have to abandon one network in order -- if
5 one is a merchant, one doesn't have to abandon one network in
6 order to take another network?

7 A That's correct.

8 Q And is that a factor that's relevant to whether tipping
9 is a serious possibility in the credit card network industry?

10 A Yes. I mean, it's a factor that's been identified by
11 economists, generally. It's what's known as multi-homing.
12 And we talked about single homing on the cardholder side and
13 to extent that that happens, although many cardholder
14 multi-home. There's also multi-homing on the merchant side,
15 which is quite prevalent. And as we were just discussing, it
16 means you don't have to pick between one and the other, and so
17 that greatly diminishes the tipping and makes it feasible --
18 or more likely that multiple networks will survive.

19 Q You can put that aside. I'd like to look at --

20 MR. CONRATH: The exhibits, we just found the number
21 for.

22 Q So I'd like to direct your attention to DX6466A, which is
23 your initial expert report and figure six.

24 A Yes.

25 Q All right. Do you recall some questions about this from

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1 counsel for American Express?

2 A I recall I was asked questions.

3 Q The blue line here is what's described as American
4 Express' effective discount rate overall, right?

5 A That's correct.

6 Q You were asked some questions about whether it was --
7 whether you included or not co-brand payments, right?

8 A I certainly asked that. I can't remember if it was in
9 conjunction with this or others. But yes, I was asked about
10 co-brand payments and calculating discount rate.

11 Q Would you explain to us why you thought it was
12 appropriate not to include co-brand deal payments in trying to
13 measure what you were trying to measure with this chart?

14 A The central reason is co-brand payments were payments
15 precisely for that; they're payments for card issuance. In a
16 way it's paying the merchant in its role as a distributor of
17 cards. It's not something that's -- it's not a charge or a
18 negative charge having to do with the merchant acceptance.

19 Q Do you recall that there was also some discussion of a
20 prepurchase of Delta SkyMiles. Do you recall that discussion?

21 A Yes.

22 Q And that I think was also a payment from American Express
23 to Delta, buying some SkyMiles, and you thought that was also
24 inappropriate to include in the discount rate calculation you
25 were doing in Defendants' Exhibit 6466A; is that right?

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1 MR. CHESLER: Your Honor, objection. The
2 questioning was about the use of the funds, not the payment
3 itself. I believe the questions were very clear in that
4 record. Then Counsel's question asked whether the witness
5 thought it was appropriate or inappropriate to include the
6 actual payment of the billion dollar prepayment. That was not
7 the question.

8 MR. CONRATH: I'm not sure I see the difference, but
9 I'll be glad to rephrase the question.

10 THE COURT: Rephrase the question, if you like.

11 THE WITNESS: I do see the difference.

12 MR. CONRATH: There you go. Once again I'm the odd
13 man out, your Honor.

14 THE COURT: Roll with the punches.

15 MR. CONRATH: I have a suspicion that I understand.

16 THE COURT: Go ahead.

17 Q You concluded that it was not appropriate to include the
18 use of the funds connected with the prepurchase of SkyMiles
19 as -- in calculating your estimate here of the effective
20 discount rate, right?

21 A That's correct.

22 Q And could you explain what was the reasoning behind why
23 you thought that was not the right thing to include?

24 A Again, if I'm remembering it correctly, that prepurchase
25 was part of the competition to obtain the co-branding

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1 agreement, and it was essentially a payment for the
2 co-branding, so, again, it was about obtaining card issuance.

3 Q And the prepurchase of SkyMiles is something that
4 American Express has to do in order to just to run a Rewards
5 Program that includes offering Delta SkyMiles; is that right?

6 A I don't know if they have to prepurchase it or not.
7 Certainly at some point they would have to purchase them.

8 Q So if -- and just to be clear, if Delta gets some money
9 in connection with a co-brand payment or in connection with
10 the use of the money on prepurchase of miles, that doesn't do
11 anything to benefit other -- doesn't do anything to reduce the
12 discount rate that's paid by, say, United Airlines, if United
13 experienced a price increase at the same time; is that right?

14 A That's correct.

15 Q It certainly doesn't do anything to benefit a big box
16 retailer if they were facing price increases, trying to
17 recapture price increases at the same time?

18 A That's correct.

19 Q Now, I'd like to ask another question about this, because
20 this, the blue line, the overall average, American Express
21 discount rate, is relatively flat during the period you've
22 shown on your -- most of the period that's shown on this
23 figure six; is that right?

24 A Yes, that's correct.

25 Q And so how is it that the overall effective discount rate

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1 is flat at a time when, as you've previously testified, value
2 recapture price increases were increasing prices to some
3 merchants?

4 A I'd say we're increasing prices to some merchants, and
5 that's reflected, for example, in the T&E merchants line,
6 where value recapture was particular prevalent. The other
7 thing that this line is capturing, though, it changes in
8 merchant mix. And to extent of what's happened on a very
9 broad level, as we talked about earlier with counsel for
10 American Express, just as Visa and MasterCard were moving --
11 well, I -- let me step back.

12 Talked about earlier, counsel for American Express,
13 that American Express moved away from T&E and more into other
14 merchant categories and that trend has continued, and those
15 other merchant categories, even within non-T&E, they've been
16 moving into ones with lower discount rates. So as the mix of
17 merchants changes the average discount rate associated with
18 that mix has been going down.

19 Q All right. So for purposes of your evaluation of the
20 value recapture price increases and what impact they had on
21 your opinion, is your evaluation of those price increases
22 diminished by the fact that the average American Express rate
23 overall remain flat during this period?

24 A No, I was looking at the value recapture price increases
25 and trying to look with as narrow a focus as possible in order

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1 to isolate those price changes from other things, because I
2 believe we talked about over the last two days, there can be a
3 variety of factors driving prices, and so that value recapture
4 analysis -- or my analysis of value recapture tended to focus
5 on those specific effects to isolate other effects such as mix
6 changes.

7 Q Do you recall some questions from counsel for American
8 Express related to the proposition that American Express says
9 that today they do not have a premium versus Visa and
10 MasterCard?

11 A Yes.

12 Q If what has happened -- if that's true, and if what has
13 happened is that Visa and MasterCard rates have increased up
14 to American Express rather than American Express rates coming
15 down to Visa and MasterCard, is that -- the reason why that
16 gap has changed relevant to your consideration of America
17 Express' position in the market?

18 A Well, as I said all along, if we're talking about rates
19 with Visa and MasterCard that affirms -- that have market
20 power, the fact that American Express had a particular premium
21 than relative to those firms was evidence as part of the
22 overall package of American Express possessing market power.
23 If it no longer has the premium at the present time, then by
24 definition the premium has not been served as additional
25 evidence, but certainly the fact that it had the premium up to

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1 that point does. And it could be relevant to understand what
2 was going on with MasterCard and Visa, but I would have to see
3 what it was that was driving their price increases.

4 Q Do you recall some questions about a dog?

5 A Actually, I don't believe we had questions about a dog.
6 I think I mentioned a dog. Yes, there was a question.

7 THE COURT: You mentioned the dog in one of your
8 papers.

9 THE WITNESS: That's right. Oh, no, it came up -- I
10 think you're the most important person to fill in at my
11 deposition.

12 THE COURT: I'm glad you think so.

13 THE WITNESS: So it was because of a discussion
14 about the loyalty, it came up in my definition.

15 THE COURT: About the food, and the loyalty, and --

16 THE WITNESS: That's right. And then, without
17 meaning to disparage American Express, the analogy being that
18 rewards were being analogized to dog food, you have to keep
19 giving the cardholders the rewards in order to keep their
20 loyalty, just the way you'd have to keep giving the dog food.

21 THE COURT: Go ahead. What is it about this? I
22 think we've gone as far as we can go with this.

23 MR. CONRATH: Perhaps. But I do have another
24 question.

25 THE COURT: No, please.

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1 Q So is it your -- let me ask you this, your analogy was
2 that if you keep feeding the dog, the dog remains loyal;
3 that's an analogy to rewards, so my question to you is can
4 insistence driven by continuing spending on rewards be a
5 source of market power?

6 A Yes. I mean, it's a source of market -- as my
7 conclusion, it's a source of market power for American
8 Express. It's also a key source of market power for Visa.
9 And I think there's agreement among economic experts on Visa
10 having market power; and I believe if you look to see the
11 basis of that, there will have to be agreement that it's being
12 driven by the loyalty or insistence of Visa cardholders.

13 Take a nonpayment industry example, and it will be
14 an old one, because I'm going to talk about newspapers when
15 they had market power, but newspapers are also an example of
16 the two-sided platform because they bring together the
17 advertisers with the viewers and subscribers. And it's
18 recognized in the past that newspapers could have substantial
19 market power with respect to advertisers, and the way they got
20 that market power is by attracting readers, which meant
21 continually having to invest in providing content that the
22 readers found attractive and, therefore, wanted to be in the
23 newspaper.

24 So it's the same mechanism, that you're attracting
25 the subscriber, and then that brings you the advertisers. And

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1 in the case of newspapers, again, before the rise of the
2 Internet, they often had substantial market power against
3 advertisers on the other side of the platform.

4 Q Do you recall some questions about Amex bringing
5 competition on the issuing side during the *U.S. V Visa* time
6 frame?

7 A Yes.

8 Q So going back to that point, Visa and MasterCard were
9 owned by the banks that had a lot of overlap between
10 themselves; is that right?

11 A Yes.

12 Q And since then there's been *U.S. V Visa*, the court
13 decision, right?

14 A Yes.

15 Q And there have been IPOs with Visa and MasterCard, so
16 that they no longer have the same overlap of ownership that
17 they had before?

18 A They have changed their corporate structure, so instead
19 of being associations, they're now corporations, but I have
20 not examined the ownership under this new corporate structure.

21 Q Bank issuers today do compete with each other even if the
22 bank issuers are on the same network; is that right?

23 A Yes, that's true.

24 Q And did you happen to -- in your reading for the Court's
25 homework assignment of Mr. Silverman's testimony, did you

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1 happen to see his testimony about the fact that competition
2 among -- the proposition that competition among issuers has
3 driven up rewards amongst a wide variety of issuers?

4 A I'm not sure I recall the specific testimony. Certainly
5 the -- I read a bunch of his testimony having to do with
6 rewards and competing by offering attractive rewards.

7 Q Is it true today that different issuers of cards, not
8 just American Express, but lots of different issuers of cards
9 are competing with each other to provide the most attractive
10 rewards for consumers in order to attract cardholders?

11 A They're certainly competing by offering what they hope
12 cardholders will consider to be attractive rewards, in order
13 to attract their business, yes.

14 Q Even if it were true 15 years ago that American Express
15 was bringing a unique form of attraction for cardholders in
16 the form of rewards, today there are lots of issuers who are
17 bringing competition to attract cardholders through rewards
18 and other programs?

19 A There was competition among issuers then there's
20 competition now, yes.

21 Q Does the -- so -- the fact that there's competition on
22 the issuing side, does that mean that competition on the
23 merchants side is something that is unimportant?

24 A No.

25 Q Could you explain why not?

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1 A Well, the prices, the profits and consumer welfare, the
2 two-sided platform, are going to depend on what's happening on
3 both sides of the platform. And competition on the merchant
4 side of the platform is going to be an important part in
5 determining that overall outcome.

6 THE COURT: Mr. Conrath, I think this may be a good
7 time to break for lunch.

8 MR. CONRATH: Sure.

9 THE COURT: After lunch, we have about an hour left?

10 MR. CONRATH: Probably about that, your Honor.

11 THE COURT: All right. And you anticipate that you
12 have very much on recross, at this point?

13 MR. CHESLER: Not so far, your Honor.

14 THE COURT: And so after Professor Katz' testimony
15 is completed, we'll take a ten-minute break, and then you'll
16 call your next witness after that.

17 MR. CHESLER: Our first witness, your Honor. We had
18 several in their case.

19 THE COURT: I know that. I wasn't going to correct
20 you, though, because I think I've done enough of that already.

21 MR. CHESLER: As far as I'm concerned, your Honor,
22 that's where we are.

23 THE COURT: That's good. We'll take an hour for
24 lunch. Thank you.

25 MR. CHESLER: Thank you, your Honor.

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(Lunch recess.)

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(Proceedings continued on the following page.)

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1 A F T E R N O O N S E S S I O N

2 THE COURT: Be seated, everyone.

3 All right. You may continue, sir.

4 MR. CONRATH: Thank you, Your Honor.

5 THE COURT: I remind the witness he's still under
6 oath.

7 THE WITNESS: Yes.

8 M I C H A E L K A T Z, having been previously
9 duly sworn was examined and testified as follows:

10 REDIRECT EXAMINATION (Cont'd.)

11 BY MR. CONRATH:

12 Q Professor Katz, could you turn to DX 7747 which was your
13 speech in Lisbon and I think it should be in the second
14 binder.

15 A 7747?

16 Q That's right.

17 A Yes.

18 Q So, turn to the last page of DX 7747, if you would.

19 A Yes.

20 Q All right. So, I think you said, but correct me if I'm
21 wrong, that at this time there was some discussion of whether
22 direct regulation of credit card network fees was appropriate
23 in Europe?

24 A You're asking me if that's what I was saying in this
25 article?

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1 Q Yes.

2 A I would have to look at the article to refresh my
3 recollection but that sounds right.

4 Q Do you recall that there was a time when that was an
5 issue in Europe?

6 A Yes.

7 Q Okay. I would like to direct your attention to the
8 sentence that is like the third sentence from the end of your
9 speech, "but I have yet to hear," do you see that?

10 A Yes.

11 Q Okay. Let me read that and tell me if this is what you
12 said: "But I have yet to hear a sound argument that as a
13 matter of course regulation is likely to lead to better
14 outcomes in two-sided markets than would competition subject
15 to competition policy oversight."

16 Did I read that right?

17 A Yes, you did.

18 Q Were you making the point in Lisbon that it is
19 appropriate to treat two-sided markets by relying on
20 competition subject to competition policy oversight?

21 A That was one of the points I was making, yes.

22 Q And that that was an appropriate answer superior to
23 regulation, is that right, direct regulation?

24 A That's certainly what I'm saying there, that I hadn't
25 heard an argument otherwise.

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1 Q And does competition policy oversight include antitrust
2 enforcement?

3 A Yes, the competition policy tends to be the word used
4 with European audiences but I understand it -- well, I
5 actually understand it to be slightly broader than antitrust
6 enforcement but largely synonymous.

7 Q You recall some questions about tipping and the
8 possibility that Visa might do something and you acknowledged
9 that Visa -- you could imagine that Visa could do something
10 that was anti-competitive in the space of the credit card
11 network industry?

12 A Yes.

13 Q Is it correct that competition policy in this country,
14 actions by a dominant firm that harm competition are addressed
15 either by government enforcement, such as the U.S. v. Visa
16 case, or by private lawsuits or sometimes by legislation
17 rather than by private self-help action?

18 A Those are certainly all possible responses, yes.

19 Q Professor Katz, I'd like to direct your attention to
20 DX 4583 in the second binder. These are some of the surveys
21 that counsel went over with you that relate to debit and
22 credit.

23 Do you have it there, DX 4583?

24 A Yes, I do.

25 Q Would you note the date that's on the front page of

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1 DX 4583.

2 A It says May 2009.

3 MR. CONRATH: May we switch control of the screens,
4 Your Honor, although I don't think this document cannot be
5 displayed.

6 THE COURT: All right. Okay.

7 Q And if we look at the next two pages of DX 4583, do you
8 see there are charts there that Mr. Chesler directed your
9 attention to and what years are encompassed in the data on
10 those charts?

11 A The first two pages, it looks like the data are all from
12 2008 and 2009.

13 Q And if I could test your memory of the -- let's test your
14 coordination, ask you to look at slide 41 in your slides.

15 MR. CONRATH: Slide 41 could be public.

16 THE COURT: What's that?

17 MR. CONRATH: Slide 41 could be public.

18 THE COURT: Do you have it?

19 THE WITNESS: I do have it, yes, this one.

20 We have our copies.

21 Q All right, that's fine.

22 What was happening to credit in the period 2008 and
23 2009 in general in the economy?

24 A In general the volume of credit transactions, credit and
25 charge card transactions were falling over that period which,

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1 as we talked about before, was the Great Recession and then it
2 started to recover at the end of 2009.

3 Q Referring to slide 41, other than the period from 2008 to
4 2009, was there ever another year on the years covered on this
5 chart from 1990 to 2011 when credit card purchase volume
6 declined on year-over-year basis?

7 A No.

8 Q So, looking back at DX 4583, the document that you were
9 examined by counsel for American Express, you see a quote at
10 the top of the page that says: "There has been a shift to
11 debit and Interlink as credit share volume and transactions
12 decline."

13 That quote refers to charts that measure activity
14 during the period of the Great Recession when credit generally
15 was declining, isn't that right?

16 A Yes, generally that's right.

17 Q Now, more generally the surveys here that we're looking
18 at relate to consumer behavior with respect to use of credit
19 and debit; is that right?

20 A I said more generally -- if you could repeat.

21 Q The data reported in DX 4583 relate to consumer behavior
22 with respect to credit and debit; is that right?

23 A I mean I believe it reflects the behavior of both
24 merchants and their customers. So, if by consumer you mean
25 their customers, that's certainly reflected in here.

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1 Q And it is relevant to the question of whether merchants
2 will continue to accept credit cards only in the ways you
3 described this morning that there's a joint decision by both
4 parties; is that right?

5 A Yes, if I understand the question. Well, if the question
6 is is customer behavior relevant in assessing the increases to
7 the merchant, the price increases to the merchant and it's
8 relevant as it factors through merchant behavior, yes, that's
9 correct.

10 Q Professor Katz, you had some questions this morning that
11 related to the fact that AmEx sometimes bargains with
12 merchants, do you recall that?

13 A Yes.

14 Q Is it correct from an economic perspective that even a
15 monopolist may negotiate?

16 A Yes.

17 Q And why is that?

18 A Well, I mean a monopolist, I'm assuming you're talking
19 about a profit maximizing monopolist, may not know the
20 willingness to pay of every one of its potential customers and
21 so it may engage in a bargaining process as part of getting to
22 a price that it thinks is an optimal price for dealing with
23 that particular customer and the bargaining process is a way
24 to do that.

25 Q And that, if it's true of a monopolist, would that

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1 principle also apply to a firm that has market power?

2 A Yes.

3 Q Go ahead?

4 A Yes, I mean in fact for it to make sense to engage in
5 bargaining there has to be some reason you think there could
6 be a different outcome of the price. If you were a perfectly
7 competitive firm, you would just look at what the market price
8 is, there would be no reason to bargain at all. Yes, you
9 could see a firm with market power engage in bargaining.

10 Q Does that include firms that have substantial market
11 power?

12 A Yes.

13 Q Do you remember a question the nature of which was if the
14 government were arguing that, then it described vertical -- a
15 certain treatment of vertical restraints under the antitrust
16 law, do you recall that?

17 A I'm not sure which question you're asking.

18 Q There was a question that Mr. Chesler asked you that said
19 if the government were arguing that vertical restraints were
20 only unlawful in certain circumstances, now do you recall that
21 question?

22 A I mean the general gist of it, yes. It was something
23 about only if it pertained to intra-brand competition and not
24 inter-brand but I don't remember the specific question.

25 Q And actually I have a very narrow point for you which is

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1 to say when you were answering that, you were answering it in
2 the if sense and you were not agreeing that Mr. Chesler had
3 correctly characterized the government's position, isn't that
4 right?

5 A That is correct.

6 Q Could you turn to DX 6507 which is your -- or maybe your
7 second report, if you prefer that volume.

8 If you would turn in DX 6507 to paragraph 148 please
9 on page 78. Do you recall Mr. Chesler read you portions of
10 the first paragraph and perhaps the second to the proposition
11 that American Express is an important competitive check on the
12 exercise of market power by MasterCard and Visa; do you recall
13 that discussion?

14 A Yeah, my recollection is that he read paragraph 148.

15 Q Could you turn the page please to paragraph 150, and I
16 think this was not read to you but I'd like to have it also in
17 the record and ask you if this is also your opinion:

18 The fact that competition from American Express has
19 important consumer benefits does not give American Express a
20 free pass to engage in anti-competitive actions on the grounds
21 that those actions benefit American Express. Indeed, this
22 fact has the opposite implication. Weakening American Express
23 alone would be sufficient to have significant harmful effects
24 on competition and consumers, then it follows that weakening
25 competition among all credit and charge card networks, which

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1 is the effect of American Express's merchant restraints, will
2 harm consumers by even more."

3 Did I read that correctly?

4 A Yes.

5 Q And is that an important corollary to the opinion you
6 expressed in paragraph 148?

7 A Yes, I stand by the opinion, I guess you could say it's a
8 corollary.

9 Q Do you remember some discussion with counsel for American
10 Express around the question of whether merchants are able to
11 determine what a particular Visa or MasterCard type of card
12 costs when it's presented?

13 A Yes.

14 Q I'd like to ask you some questions about that in relation
15 to economic principles. Is it correct that it could be of
16 value to merchants to be able to determine how much a
17 particular Visa or MasterCard costs if the merchants could use
18 that information to steer customers?

19 A Yes.

20 Q All else equal, if merchants have no ability to steer,
21 there would be little reason for merchants to invest in
22 technology that would allow them to determine the costs of a
23 particular Visa or MasterCard, isn't that correct?

24 A Yes, if you're saying as part of that did they know what
25 the average cost is, yes, because they would just have to

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1 accept cards on average so that additional information would
2 not have any value that I can think of as I sit here.

3 Q But if they did obtain the ability to steer amongst them,
4 then there might be reason for merchants to invest in
5 technology?

6 A Yes.

7 Q All else equal?

8 A Yes.

9 THE COURT: Are you saying that if a merchant knew
10 the relevant discount rates for different cards within the
11 Visa portfolio, that if he were presented with a Premier Visa
12 card which had a discount rate of three point something
13 percent, I don't know that that's the case but, that if the
14 merchant had the ability to steer to other cards, the merchant
15 might say, do you have an American Express Card, knowing that
16 the discount rate for that card was a lower rate?

17 THE WITNESS: Yes, and I suspect a large
18 sophisticated merchant could have incentives to do that sort
19 of thing because the differences among the MasterCard and Visa
20 credit cards, I recall some of those differences are
21 significant.

22 Q Professor Katz, do you recall some questions about your
23 testimony during U.S. v. Visa on the subject of American
24 Express and its market positions, its possession or not of
25 market power?

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1 A Yes, although that was a couple of hours ago, I have a
2 vague recollection, yes.

3 Q Maybe I can refresh your recollection about that.

4 MR. CONRATH: If I may approach, Your Honor?

5 THE COURT: Yes. Yes, you may.

6 MR. CONRATH: Thank you.

7 Q Professor Katz, I've handed you DX 0743. These are
8 excerpts, pages 3581 and then page 3803 through 3804.

9 Do you have that?

10 A Yes.

11 Q This is your testimony before Judge Jones?

12 A I don't know.

13 Q Let me direct you to the particular question and answer
14 I'm going to ask and I'll ask if you recognize it. I see that
15 it does not -- the excerpts we were able to copy do not have
16 your name on them, but look on page 3804 please, the first
17 full question and answer, do you see that?

18 A Yes.

19 Q And do you recognize that as your testimony?

20 A Give me one minute to read it.

21 Q Yes, of course.

22 (Pause.)

23 A I believe this is my cross-examination, yes.

24 Q And were you asked at that point the following question
25 and did you give the following answer:

Katz - redirect - Conrath

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1 "Question: If the Corporate Card in fact
2 constitutes a separate market, is it a market American Express
3 is able to exercise market power?

4 "Answer: I haven't fully analyzed it as a
5 separate market but it would be my opinion that American
6 Express would have market power."

7 And that was your view at the time of U.S. v. Visa?

8 A My view, what I stated here at the time of my
9 cross-examination, yes.

10 MR. CONRATH: One moment, Your Honor. (Pause.)

11 One moment. I'm sorry, Your Honor.

12 THE COURT: No problem.

13 (Pause.)

14 Q Do you recall some questions, Professor Katz, about
15 your -- a variety of questions in fact about your testimony in
16 United States versus First Data?

17 A Yes.

18 MR. CONRATH: May I approach, Your Honor?

19 THE COURT: Yes, you may.

20 Q (Handing.)

21 A Thank you.

22 Q I have handed you, Professor Katz, PX 2711 which is
23 defendant's pretrial memorandum in this case and I'd like to
24 direct your attention to page 83.

25 A I'm there.

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1 Q All right. Do you see at the top of the page -- sorry, I
2 was on the wrong page. The problem was mine.

3 At the bottom of page 83 it has a quotation from
4 you, do you see that?

5 A Yes, I do.

6 Q All right. And this is a quotation that you were read
7 this morning and you answered questions about this quotation;
8 do you recall that discussion?

9 A I'm not sure I recall being read this and being told it
10 was a quotation but I had questions on something similar to
11 this.

12 Q All right. Well, let's try to get at that. In the first
13 sentence here it says: "It is impossible to calculate any
14 harm to consumers from changes in -- and then there's a word
15 in brackets, it says discount rates without considering both
16 sides of the market."

17 Do you see that?

18 A Yes, I do.

19 Q And a little bit later in that it refers to the effects
20 of, and again discount is in brackets, discount fees on
21 consumer welfare, the effects of discount fees on consumer
22 welfare can be understood by looking solely at the merchant
23 side of the market; is that right?

24 A That is what it says, yes.

25 Q All right. Could we look at your expert -- the citation

Katz - redirect - Conrath

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1 here is to your expert report in U.S. v. First Data; is that
2 right?

3 A That's correct.

4 Q Could we look at your expert report in U.S. v. First Data
5 which is DX 7183.

6 A I'm guessing it is volume one.

7 Q Yes, I think so.

8 A I'm sorry, could repeat the number please.

9 Q DX 7183. I'd like to ask you to direct your attention to
10 paragraph 156 in DX 7183.

11 A Yes.

12 Q So, if you look at that, the relevant sentence that's
13 quoted there in paragraph 156 of DX 7183, were you in fact
14 talking about discount rates in that paragraph?

15 A No, what I said in the paragraph, both places where the
16 word "discount" appears in square brackets I was talking about
17 the interchange rate.

18 Q All right. Can you clarify for us whether it makes a
19 difference whether one is referring to an interchange rate or
20 a discount rate?

21 A It makes a huge difference for these purposes because
22 with an interchange rate, which is what I was talking about in
23 my report, by definition it is a pass-through the network
24 passes through, so that when the interchange rate goes up, the
25 merchant is paying more and the cardholder side of the market

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1 is paying less. That's what the interchange is doing, it is a
2 transfer from one side to the other. It is impossible to
3 raise the interchange to the merchant without then having an
4 equal and offsetting effect of interchange on the other side
5 because that's the definition of interchange is a payment from
6 one side to the other. And so, what I was testifying to in
7 the First Data case is saying, well, it doesn't make sense to
8 say here's what happens when you raise to one side and
9 simultaneously lower to the other side and look only at the
10 one side.

11 Now, in talking about a merchant discount, it's
12 certainly correct, the interchange is the biggest portion but
13 there are other pieces and because of those other pieces such
14 as the network fees it certainly is possible to raise the
15 merchant discount without affecting the price on the other
16 side, whereas that's a logical impossibility in the case of
17 changing just the interchange rate. So, it is a very
18 significant difference, it is just a different meaning.

19 Q And so, your criticism in the expert report in the First
20 Data case, your criticism of Professor Ordoover who was at that
21 point the government's witness, was that the theory of raising
22 interchange rates inherently involved evaluation or a rate
23 that had affected both sides of the market; is that right?

24 A Yes, the interchange inherently affects both sides and
25 therefore you should take that into account when assessing the

Katz - redirect - Conrath

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1 effects of a change in the interchange rate.

2 Q In this case is your theory that the harm caused would be
3 a raise in interchange rates?

4 A It is my testimony that as a result of the harm to
5 competition which then reduces the sensitivity to price on the
6 merchant side but that that will raise what the networks will
7 keep but I also anticipate that that would have an effect on
8 the interchange as well by affecting the balance.

9 Q So, your testimony is that if the merchant discount rates
10 go up, have gone up as a result of the reduction in
11 competition, some of that stays with the network and doesn't
12 pass through to the other side, is that right?

13 A That's correct.

14 Q And all of the many quotations that you were read
15 concerning First Data were in the context of your criticizing
16 Professor Ordoover for a theory that was about interchange
17 rates only; is that right.

18 A That's my recollection as I sit here. I was read several
19 quotations but that's my recollection.

20 Q Do you recall being asked some questions about the
21 U-shaped charts, the charts that showed usage of credit and
22 debit at a variety of retailers that we didn't -- whose names
23 we didn't mention?

24 A Yes.

25 Q And you also looked at some variations of those charts

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1 done by Professor Bernheim, is that right?

2 A Yes.

3 Q Could you turn please to those charts which are at
4 DX 7761. I think it's in the second binder. Do you have
5 those? And can you also get from your slides slide 45 which
6 is the version that is from your report.

7 (Pause.)

8 All right. Do you have that?

9 So, let's start with asking you questions about
10 slide 45 of the slides that you presented in your direct.
11 So, the bars on this chart that reflect people who used
12 credit cards either exclusively or in some mix are all the
13 bars except the far right-hand bar; is that right?

14 A That's correct.

15 Q If you were doing a hypothetical monopolist test
16 encompassing a SSNIP on the question of whether merchants can
17 drop credit cards if there were a SSNIP, what of these bars
18 would you consider that a merchant should focus on in
19 evaluating whether to drop credit cards?

20 A I mean I think the merchant should take into account all
21 of the bars in thinking about it because it is providing
22 information to the merchant about how its customers view the
23 different payment instruments. Certainly if I were the
24 merchant though, I would have concerns about the people who
25 have used credit exclusively but also the people who almost

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1 always use credit as well is my concern as a merchant is that
2 those are people who would spend less in my establishment if I
3 no longer accepted credit and charge cards.

4 Q And for those people who had used some of both, the
5 merchant would have to consider them because those might be
6 people who, for instance, are making particular types of
7 purchases, always used credit cards, for example,
8 prescriptions might be a lot more expensive than sundries,
9 than shampoo?

10 A Yes, that's certainly a possibility.

11 Q You looked at the data that created slides 45, 46 and 47
12 from three merchants; is that right?

13 A That's correct.

14 Q And AmEx's expert eventually looked at five, is that
15 right?

16 A I don't recall as I sit here but there are five that were
17 shown to me earlier today. I can't remember if he did -- I
18 know he did at least five.

19 Q That was a better question, thank you.

20 And I want to be clear, you testified that the
21 reason you looked at three was that these kind of analyses are
22 quite expensive?

23 A Yes.

24 Q During the questioning do you recall that counsel for
25 American Express tried to call attention to the fact that

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1 certain -- well, let's -- actually I need to clarify what's in
2 Dr. Bernheim's charts.

3 So, if we could look at the first page, the first
4 page that's in your binder, it's actually page 12 of DX 7721;
5 what's on the left, correct, is what is -- the blue bars are
6 bars taken from your analysis, the analysis that you did, is
7 that right?

8 MR. CHESLER: Excuse me, Your Honor, I think counsel
9 misspoke, I think counsel said 7721, it is 7761.

10 MR. CONRATH: Yes, thank you. I appreciate that.
11 Let me start again so I don't have a muddled record.

12 Q In DX 7761, page 12, there are two pairs of bar charts;
13 is that right?

14 A Yes.

15 Q And the one on the left is taken from your bar chart that
16 was used with -- that is in this case, your slide 47; is that
17 right?

18 A I don't know, we'd have to look. I mean it certainly
19 says that it used the same threshold number of transactions
20 and refers to the matching we did to use BIN data but I don't
21 know whether there are other things he did to the data that
22 might be different. It's not labeled as reporting the exact
23 numbers I did. I'd have to go check to see if that's what
24 they are.

25 Q And a difference is that the percentages, the two bars in

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1 Professor Bernheim's chart where he's looking at loyalty cards
2 with two transactions, the percentages add up to 100 percent
3 and they reflect -- they basically exclude consumers who used
4 only debit; is that right?

5 A That's certainly a difference, yes.

6 Q All right. And the additional analysis done by
7 Dr. Bernheim was with cardholders who you had at least ten
8 transactions and that's the green bars; is that right?

9 A Yes.

10 Q So, first, do you recall that counsel tried to draw
11 attention to the fact that the two which are the last two that
12 were merchants that you didn't focus on, as he said, had a
13 higher number who used both general purpose credit cards and
14 debit cards than the ones you referenced, do you recall when
15 he tried to call attention to that fact?

16 A Yes, I think it was either showing that it was a higher
17 percentage but yes.

18 Q A higher percentage, you're correct.

19 So, we didn't mention the numbers yesterday but
20 because the identities are not disclosed I think I can
21 actually mention the numbers, I just want to call out just how
22 significant or not that difference was that counsel was
23 calling attention to. So, the highest number in that column
24 for ten transactions among the three that you looked at was
25 70, is that right, 70 percent?

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1 A I'm sorry, the highest --

2 Q So, look at the highest --

3 A You're saying the highest percentage for those who used
4 general purpose credit and charge cards and debit?

5 Q Yes?

6 A Yes.

7 Q That's 70. And the ones counsel was calling attention to
8 that were higher are 75 and 76; is that right?

9 A Yes.

10 THE COURT: And that's using Professor Bernheim's
11 methodology, is that it, of ten or more transactions?

12 MR. CONRATH: Yes.

13 THE COURT: Go ahead.

14 Q Now, looking at DX 7761 and these bars, I'm going to ask
15 you again to consider if a merchant was -- or if you were
16 doing a Hypothetical Monopolist Test or, more precisely, if
17 you're thinking about what customers a merchant would need to
18 keep in mind if it was thinking about dropping all credit
19 cards, of the two bars, the ones who used only general purpose
20 credit cards or the ones who used both general purpose credit
21 cards and debit, which bar is more important to the merchant?

22 A I'm sorry, are you asking me if I'm thinking about -- if
23 I were a merchant and asking myself the question which
24 customers do I think would be more at risk if I were to drop
25 acceptance of general purpose credit and charge cards, it

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1 would be, picking between the two bars, it would be the bar of
2 people who used them exclusively.

3 Q And looking at the percentages on those bars, if we look,
4 for example, at the first merchant, the one on page 12 of
5 DX 7761, of the two groups that are reported here, what this
6 reports is that 35 percent of those customers who came to the
7 store at least ten times and always used credit, is that what
8 this first bar means, the first green bar means?

9 A Yes.

10 Q And that's something a merchant would have to take
11 seriously into account in thinking whether the merchant should
12 drop all credit cards; is that right?

13 A I mean it should take it into account, yes.

14 Q And the other percentages range from 24 to 35; is that
15 right?

16 A I thought we looked at the -- I think the other ones
17 range from 24 to 34.

18 Q And those are of people who came to the store at least
19 ten times and used only credit; is that right?

20 A That's correct.

21 THE COURT: Can I just interrupt for a minute. On
22 the last area of questioning about where there was an issue
23 about the interchange fee changing, that has an effect on
24 merchants and then you said on the other side of the equation
25 it would have an effect on the customer.

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1 THE WITNESS: Yes.

2 THE COURT: And how would it manifest itself if the
3 interchange fee increased? I know how it manifests itself
4 with regard to the discount rate that affects the merchant.
5 How does that manifest itself with regard to the customer?

6 THE WITNESS: So, a slight complication. Let me
7 start with taking it back to First Data because it is a little
8 clearer. I believe there, I may be wrong, I think there the
9 focus was on the customer actually being the debit card issuer
10 because you remember, right, we've got the five steps, so
11 sometimes in these cases we look what -- usually people ignore
12 the acquirers because it is so competitive, they just sort of
13 pass things through.

14 THE COURT: You mean the acquirer who is the
15 connection to the network from the merchant?

16 THE WITNESS: That's right but sometimes we end up
17 focusing on the link between the network and the issuer and
18 talk about the issuers as customers and in fact in U.S. v.
19 Visa my testimony was that the issuers wouldn't have somewhere
20 else to go if the network raised fees to them, if I'm
21 remembering it correctly.

22 THE COURT: The issuer meaning like a bank, like
23 Chase or Citibank?

24 THE WITNESS: That's right. The reason I want to
25 start with that is so when the interchange rate goes up, it

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1 means you're charging more to the merchant side but then by
2 definition you're giving more to the issuer and then what
3 you'd expect is the issuers would then pass some of that on to
4 their cardholders but the immediate effect is that the
5 merchant side goes up and then the issuer side goes down by
6 exactly the same amount.

7 THE COURT: And how would the issuer pass that along
8 to the cardholder?

9 THE WITNESS: So in the case of --

10 THE COURT: By increasing the interest rate or some
11 other means?

12 THE WITNESS: So, in the case of credit and charge
13 card networks one of the ways you would see it is when the
14 issuer was getting paid more by the network for each dollar of
15 charge volume, it might increase its rewards for example.

16 THE COURT: So that would benefit the cardholder?

17 THE WITNESS: Yes, and that was the point I was
18 making in the First Data case.

19 THE COURT: I see.

20 THE WITNESS: You're taking money from one side and
21 passing it to the other and so you should think about that
22 effect.

23 THE COURT: I see. Okay. Thank you.

24 Q Professor Katz, I'd like to direct your attention to
25 DX 7580 which I believe is in your second binder and which is

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1 the government's competitive impact statement that was
2 discussed with you on cross.

3 A Yes.

4 Q Would you turn please to page 14 of DX 7580. Do you have
5 that?

6 A Yes.

7 Q All right. Do you recall that you were read the first
8 paragraph on that page concerning merchants that accept only
9 Visa or MasterCard?

10 A Yes.

11 Q I think you were not read the second paragraph and I'd
12 like to read it to you and ask if you agree with it.

13 "Merchants that accept American Express cards,
14 including the vast majority of the major retailers in the
15 United States, will be unable to influence customer's payment
16 methods because the anti-competitive American Express merchant
17 restraints will continue to constrain those merchants pending
18 the outcome of this litigation. American Express stands as
19 the last obstacle to achieving the full benefits of
20 competition now suppressed by the challenged merchant
21 restraints."

22 Do you agree with those observations as well,
23 Professor Katz?

24 A Depends on the interpretation of that last sentence. My
25 conclusion in my analysis is that while on paper Discover

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1 rules could be the last obstacle, as a practical matter they
2 will not be a binding constraint.

3 MR. CONRATH: Your Honor, I don't want to let the
4 moment pass without reminding you that you might have
5 questions about Professor Katz's Silverman homework, if you
6 had things you wanted to follow up on, I don't want to leave
7 that, but that concludes my questions.

8 THE COURT: All right. I think that's sufficient.

9 MR. CONRATH: That we've gotten there.

10 THE COURT: I think we're there.

11 Anything else from the defense?

12 MR. CHESLER: No questions, Your Honor.

13 THE COURT: All right. The Professor is excused.

14 THE WITNESS: Thank you, Your Honor.

15 THE COURT: Have a nice day. Have a good trip home.

16 THE WITNESS: Thank you.

17 THE COURT: You may stand down.

18 (Witness steps down.)

19 THE COURT: A couple of things, we're going to take
20 a ten minute break, and police up the materials here but
21 before we did that, there are two things; one is does the
22 government have any additional witnesses on its case?

23 MR. CONRATH: Just the one from who has been ill who
24 is scheduled I think for August 11.

25 THE COURT: Apart from that?

1 MR. CONRATH: Apart from that, we do not.

2 THE COURT: Apart from that, the government rests?

3 MR. CONRATH: I think we also have some documents
4 that we'll offer when we find ourselves at the end of a day
5 after we've resolved as many objections as we can resolve but
6 those two things are what remains in our case, Your Honor.

7 THE COURT: All right. Very good.

8 Before we go any further I just want to remind
9 everyone that the Court agreed that during the government's
10 case for the purposes of efficiency the American Express
11 company witnesses that the government called were also
12 questioned by the defense on direct so that they wouldn't have
13 to come back, so some of the defense case has already been
14 heard, principal defense case has already been heard during
15 the, in effect, the cross-examination of some of the American
16 Express witnesses.

17 Isn't that right, Mr. Chesler?

18 MR. CHESLER: Yes, Your Honor.

19 THE COURT: Okay. So, there may have been some
20 people who didn't hear that at the beginning of the trial, I
21 just wanted to make it clear that that's how we decided to
22 proceed which is a little unusual but I think for purposes of
23 a bench trial of this complexity it was appropriate.

24 All right. So, we'll begin your presentation in ten
25 minutes.

1 MR. CHESLER: Thank you, Your Honor.

2 THE COURT: You're welcome.

3 (Time noted: 2:50 p.m.)

4 (Recess taken.)

5

6

7 THE COURT: Please be seated.

8 Yes, sir.

9 MR. CONRATH: If I may introduce a colleague who
10 hasn't been at the table before, Mark Ryan.

11 THE COURT: Welcome. Are you from Washington too?

12 MR. RYAN: I am, Your Honor.

13 THE COURT: Welcome to New York.

14 MR. RYAN: Thank you.

15 THE COURT: Mr. Chesler, you may call your witness.

16 MR. CHESLER: Thank you, Your Honor. We call
17 Kenneth Chenault.

18 (Witness takes the stand and is sworn by the clerk.)

19 THE CLERK: Please have a seat and please state and
20 spell your full name for the record.

21 THE WITNESS: Yes, Kenneth Irvine Chenault,
22 K E N N E T H, I R V I N E, C H E N A U L T.

23 THE COURT: You may inquire.

24 MR. CHESLER: Thank you, Your Honor. May I approach
25 the witness with some documents?

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1 THE COURT: Yes, you may.

2 MR. CHESLER: (Hanging.)

3 THE WITNESS: Thank you.

4 K E N N E T H C H E N A U L T, having been first duly
5 sworn was examined and testified as follows:

6 DIRECT EXAMINATION

7 BY MR. CHESLER:

8 Q Mr. Chenault, you're employed by American Express
9 Corporation?

10 A Yes, I am.

11 Q And what is your position there?

12 A I'm Chairman, Chief Executive Officer.

13 Q And how long have you been at the company, sir?

14 A For 33 years.

15 Q And how long have you been the Chairman and Chief
16 Executive Officer?

17 A For 12 years.

18 Q Just briefly would you just describe for the Court --

19 A Actually 13. It sounds like it's a lot of fun.

20 Q Before that 13-year period, would you just briefly
21 describe for the Court what your positions were as you moved
22 through the company?

23 A Yes, I joined the company in September of 1981 as the
24 Director of Strategic Planning and that was sort of a middle
25 management position and I served in that position for I think

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1 two and a half years. Then I went to run a marketing area in
2 what was at that time called the Merchandise Sales Division
3 that sold merchandise through the mail and I was Vice
4 President of Marketing; then a year and a half later became
5 Senior Vice President of Marketing; a few years later became
6 Executive Vice President and General Manager of the Gold Card/
7 Platinum Card Group; then became Executive Vice President-
8 General Manager of the Personal Card Group, and then was
9 promoted to President of the U.S. Consumer Card Group, served
10 in that position for several years, and then became Vice
11 Chairman of the company and received responsibility for our
12 U.S. and international businesses and at that time the area of
13 the company was called Travel Related Services, that had the
14 card business, travel business, travelers check business. And
15 then I believe in 1997 I was promoted to the position of
16 President and Chief Operating Officer of the company, and then
17 in January 2001 became Chief Executive Officer of the company
18 and in April of 2001 I became Chairman of American Express.

19 Q And at about the time you became the President and Chief
20 Operating Officer of the company, were you also elected to the
21 Board of Directors?

22 A Yes, I was.

23 Q Just tell the Court what your educational background is,
24 sir.

25 A I went to Bowdoin College in Brunswick, Maine and Harvard

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1 Law School.

2 Q And what did you do after getting out of law school?

3 A I went to Rogers & Wells and then I went to Bain &
4 Company, a consulting firm, and then I came to American
5 Express in 1981.

6 Q So, you've been at the company about 33 years?

7 A 33 years, yes.

8 Q Just in your own words describe for the Court please what
9 the business of American Express is?

10 A We are in the payments services business and we in fact
11 are focused on meeting the payment needs of our customers but
12 we're also in what I call the services business in that we use
13 the payments platform to provide a range of services to
14 consumers, to merchants, to corporations, to small businesses
15 and so it's very important to emphasize the service aspect of
16 our business.

17 Q And in that connection, do you describe the business or
18 at least part of the business as a closed loop?

19 A Yes. What's very important to understand is American
20 Express operates a unique business model in that we have an
21 integrated payments platform which means that we acquire
22 merchants, we do merchant processing, we are a network, we're
23 an issuer processor and we issue cards and what's critical to
24 understand is the information and data that we have because it
25 is a very interdependent model and what is critical is that we

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1 actually have a very strong link with our cardmembers and our
2 merchants and the information and data that we have in this
3 integrated differentiated model is very, very important and
4 unique in the payments industry.

5 Q I take it you compete, among others, with Visa and
6 MasterCard?

7 A We certainly do.

8 Q How does their model in connection with the closed loop
9 that you've just described, how does the Visa-MasterCard model
10 differ?

11 A In essence, Visa and MasterCard are a network and so they
12 do not acquire merchants and they do not acquire cardmembers,
13 so it is a fundamentally different model from ours. It is not
14 an integrated model, it is not an interdependent model with
15 cardmembers and merchants.

16 Q What types of cards does American Express offer?

17 A We offer a wide variety of cards. From a category
18 standpoint, we offer charge cards that are pay in full
19 products. We offer reloadable prepaid cards where you load
20 funds into the card, your funds into the card. We offer
21 revolving credit cards. We offer co-brand cards.

22 Q You also offer corporate cards?

23 A We offer cards to small businesses, to medium size
24 corporations and to large corporations.

25 Q And what is a co-brand card?

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1 A Co-brand is really a partnership with a company where
2 both of the companies' brands are on the card and in fact we
3 provide the credit to the customer, we provide the marketing,
4 we provide the customer service. From a rewards standpoint,
5 we also pay for those.

6 Q Now, does American Express have some cards that are
7 actually issued by banks?

8 A Yes, we do, we have a business that we call Global
9 Network Services.

10 Q Or GNS sometimes?

11 A GNS is really what we commonly refer to it.

12 Q And what is that business?

13 A That business is where banks will issue cards on our
14 network and it's branded with our blue box, so it has the
15 acceptance mark of our company, American Express.

16 Q How many banks are there in the United States today that
17 issue American Express cards?

18 A Nine banks.

19 Q Do you know approximately how many banks there are that
20 issue Visa and MasterCard cards?

21 A 10,000 or more.

22 Q Does American Express function as a closed loop with
23 respect to the GNS issued cards?

24 A Yes, we do.

25 Q And how do you do that given that they've been issued by

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1 a bank?

2 A What we have is, as I said, we have the information of
3 the merchant spending on the card.

4 Q Now, beyond just completing a transaction, what value do
5 you believe American Express offers to its cardmembers?

6 A I think what I would start with fundamentally is what the
7 American Express brand represents is trust; trust, integrity
8 and service, that's really what has built our company over 164
9 years. So, the affinity with our brand is very, very
10 important.

11 Q You also offer your cardmembers rewards programs?

12 A We have made substantial investments in our reward
13 programs and those programs are critical because, back to the
14 integrated model and one of the things I talk about to more
15 simply describe this integrated interdependent model is the
16 chicken and the egg, and the reality is we need more cards to
17 get more merchants, we need more merchants to get more cards
18 and I've been very clear, I don't know who's the chicken or
19 who's the egg but you need both, it is critical that you meet
20 the needs of both of those groups and so rewards plays a very,
21 very critical role because it gives the customer a reason to
22 use the card because fundamental to our model in the
23 integrated model is spend and we need welcome acceptance which
24 is a fundamental promise going to trust that is critical.

25 Rewards also create demand, not just at a particular

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1 merchant but for all merchants it creates that demand. So,
2 rewards plays a very important role. Customer service plays a
3 very important role for us because what we believe is that
4 personal recognition and providing a high level of service
5 also correlates into increase loyalty and increase spending
6 and what's very important here is we want customers who will
7 engage in responsible spending and that is critical that we
8 service those customers, that's why we invest and innovate in
9 our customer service very strongly and it is why since 2007 we
10 have won the J.D. Power Award each year.

11 Q What do you mean by responsible spending in that last
12 answer, sir?

13 A Well, I think what's critical again in our model is it's
14 a charge card, it's a pay in full product and that financial
15 discipline is very, very important, customers pay at the end
16 of 30 days, and what that builds into our psyche of our
17 customer is a level of responsibility. We don't want
18 customers who are going to spend above their means. What we
19 want, because it's critical to the positioning of our product,
20 it's important to our economics for both the cardmember and
21 the merchants, we want customers who will spend in a
22 responsible way. We also want customers that are highly
23 creditworthy. And so, from a financial economic standpoint,
24 only 15 percent of our revenues are generated from revolving
25 credit products which is fundamentally different from a bank

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1 card and is another reason why we're able to create demand for
2 merchants because with a revolving credit card the customer is
3 using some of their discretionary dollars to service debt and
4 so with us those are dollars that they can spend in a
5 responsible way which also increases demand back to the
6 chicken and the egg that I've talked about.

7 Q Let me ask you a few questions about your rewards
8 program. The name of it is the Membership Rewards, correct?

9 A Yes, Membership Rewards, it first started off as
10 Membership Miles and came out in 1991.

11 Q Do you have cups up there?

12 A Yes.

13 Q So, it was originally called Membership Miles, then it
14 was renamed Membership Rewards at some point?

15 A Yes.

16 Q I take it there are merchants who are in the Membership
17 Rewards program at which a cardmember can redeem her rewards;
18 is that correct?

19 A Yes.

20 Q Are those the only merchants who in your view benefit
21 from the Membership Rewards program, those where they
22 participate in the redemption program?

23 A No. In fact, what's important, because this was one of
24 the products that I actually led the development of,
25 Membership Miles, and the concept from the beginning was

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1 really giving customers a benefit when they use the card to
2 give them a reward for using their card. What was also very
3 important was to give them flexibility and choice, to give
4 them a range of redemption options which we really have
5 expanded substantially but also not just to give the benefit
6 to the merchant participant in the reward program.

7 So, what you have with Membership Rewards in
8 essence, and it really has built to that, is think of a
9 concept of a virtual currency, if you will, and so any
10 merchant where our card is accepted and used benefits from
11 Membership Rewards because of the increased demand and that
12 was fundamental to the creation of the program.

13 Q Now, has there in more recent years been a modification
14 or enhancement to the Membership Rewards called Pay with
15 Points?

16 A Yes.

17 Q What is that?

18 A Yes, Pay with Points is a very exciting innovation and I
19 would just emphasize that what is critical in a competitive
20 marketplace is that you're constantly innovating and what is
21 exciting about Pay with Points is it brought an early concept
22 of virtual currency to life and it gives the customer
23 tremendous flexibility and choice and increases the demand
24 even more for merchants. So, what it means is you could
25 decide I, in fact, am going to engage in the following set of

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1 spending activity, all right, I want to go on a trip at this
2 time or I want to buy a merchandise item at this time. Unlike
3 some airline reward programs where you have a blackout, you
4 can in fact use Membership Reward points to pay for that trip,
5 to pay for that merchandise and you can simply decide -- you
6 don't even have to decide at the point of sale, you can decide
7 when you get your statement that I want to pay with points.

8 So, that has become now one of the most popular
9 redemption categories because of the choice and optionality
10 that we provide to the cardmember and the benefits to all
11 merchants are there is increased demand because cardmembers
12 are saying, boy, this is a program that has incredible utility
13 and flexibility.

14 Q So, you can decide to pay part of your bill, for example,
15 with cash or check, whatever, and part of it with points?

16 A Yes.

17 Q And is there any limitation on which items on the bill
18 you can apply the points to?

19 A No.

20 Q Now, with respect to the rewards program, do you have
21 features where at times purchases at particular merchants will
22 trigger a multiplier of point reward rather than one point per
23 dollar?

24 A Yes, there could be certain categories, it could be
25 supermarkets, it could be gas stations, it could be at a

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1 particular merchant where you can earn multiple points and
2 what's very important is when you then can earn those multiple
3 points, it really results in the cardmember receiving a
4 discount and so even though they may just earn those points in
5 a certain category or at a certain merchant, their capacity to
6 spend more from a discretionary standpoint has increased and
7 that benefits all merchants.

8 Q I take it that the company incurs costs in connection
9 with the rewards program, is that fair?

10 A Yes, it is a very costly program. It's probably our most
11 significant cost item but, again, what we believe fully in our
12 integrated model that it differentiates us in the marketplace
13 and provides substantial value to the cardmember and to the
14 merchant.

15 Q You create accounting reserves for the rewards that are
16 issued to your cardmembers when they buy on the card, is that
17 right?

18 A Yes.

19 Q Now, you actually have to pay for those points when the
20 rewards are later redeemed, correct?

21 A We absolutely do.

22 Q Over time, particularly in recent years what kind of
23 adjustments, if any, have you had to make to the reserves for
24 rewards in light of the redemption rules?

25 A We've made substantial adjustments and I think what is

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1 important in this program and it is something that I
2 emphasized in our company and outside our company from the
3 beginning is historically there have been a number of reward
4 programs where in fact people, meaning companies did not
5 particularly focus on the engagement of the reward program, it
6 was more promotional. What I emphasized from the beginning
7 is we want to offer real value in everything we do to our
8 customers and one of the most important metrics that we need
9 to follow is we want engagement and so one of the things I got
10 from people inside our company as well as sometimes investors
11 is, boy, it looks like your costs are going up, engagement is
12 going up and what I say is that's terrific because that means
13 our customers are seeing value in the rewards program and our
14 merchants are benefiting from the increased demand.

15 Q Now, are you familiar with provisions in the American
16 Express agreements with its merchants that are called
17 non-discrimination provisions?

18 A Yes.

19 Q From your vantage point, what is the purpose of those
20 provisions?

21 A What is absolutely critical and fundamental when I talked
22 about our brand and trust, the most damaging thing that can
23 happen to the American Express brand is when our cardmember is
24 discriminated against at the point of sale.

25 Q Why is that, sir?

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1 A Because we've made a promise and we've told them that
2 they will receive welcome acceptance and trust, as I said
3 earlier, is one of the most important attributes of our brand
4 and has been for over 164 years. So, welcome acceptance is
5 the cornerstone of our business model.

6 Q You've described the business model of the company as a
7 spend-centric model?

8 A Yes.

9 Q How is that distinguished from the basic model of your
10 competitors, Visa and MasterCard?

11 A Spend is really the engine that drives our company and
12 what I have consistently emphasized is the moment of truth is
13 when our customer pulls their card out of their wallet and
14 they use it. So, spend really drives it.

15 Now, as I mentioned earlier, our economic model is
16 really based on spend which is fundamentally different from a
17 bank card model which is based on lend and that's why I said
18 earlier only 15 percent of our revenues are achieved from
19 lending products but one of the points that I also make in our
20 lending business and have made to investors when they've
21 asked, well, what's the objective of lending, I said our
22 objective is to get spend. So, our orientation, our strategy
23 is a differentiated strategy and is very different from a
24 lendcentric model.

25 Q Do you track, does the company track the degree to which

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1 your cardmembers tend to spend more at merchants than your
2 competitor cardmembers do?

3 A Yes, that's a very important metric for us.

4 Q I'd like you to look in the book I've put up there at a
5 document, the tab should be DX 7743.

6 I'm sorry, I asked you for the wrong exhibit. I
7 apologize, my mistake.

8 How, in your experience, does the level of spend of
9 your cardmembers compare, I don't mean specific numbers but
10 generally how does it compare to the amount that Visa and
11 MasterCard members are spending on their cards with merchants?

12 A It is substantially higher on average than the amount of
13 spending of Visa and Master cardholders.

14 Q Do you do anything -- you said you want your members to
15 spend responsibly, you want people of means who are spending
16 within their means; do you do anything to try to ensure that
17 those are the cardmembers that you have?

18 A Yes, we have put together very sophisticated models that
19 help us sort out those prospects that we believe will spend in
20 a responsible way and will also be creditworthy and that was a
21 very, very strong focus for us.

22 (Continued on next page.)
23
24
25

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1 Q And do you track your default rates, the rates of debt
2 that are not repaid by your card members?

3 A Yes. And we consistently have best performing credit,
4 because of our focus, and that's not only on our charge credit
5 card products, which, obviously, is the bulk of our portfolio
6 in our business but also our lending products.

7 Q Let me turn to the merchants for a moment, since you were
8 talking about the card member. What sorts of services does
9 American Express provide to the merchants who accept your
10 cards?

11 A Well, we provide a range of services. One, we provide a
12 range of data services to them, because we can help them
13 analyze their business and that is very, very critical. So,
14 for example, with airlines, we might help them on their route
15 structure from the analysis that we're able to do. With
16 restaurants, we have been able to help them basically focus on
17 where would be the best places to open up restaurants. So
18 what's critical is that the analysis that we're able to do for
19 them is important.

20 Second thing we do is we work with them in a range
21 of targeted marketing programs, and this is where we can
22 really bring the closed loop to life, and we can model out and
23 say people who have had purchases in certain merchandise
24 categories have a propensity to purchase more in other
25 categories. Or to say you're selling items in this category,

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1 the capacity of this customer to buy more is actually higher.
2 What I would emphasize is we do not give out any personal
3 information or data. So this is done by looking at like types
4 of customers and segments, but from a targeted marketing
5 standpoint, we're able to do a range of marketing promotions
6 for our merchants.

7 Third is in the area of fraud management, and I
8 think, clearly, everyone knows that fraud in our society, in
9 our overall economy, is a major problem. Billions dollars are
10 lost due to fraud. And because of the closed loop that we can
11 connect the merchant data and the card member data, that gives
12 us unbelievable insights into where that fraud takes place,
13 and so I think what we're doing is helping the economy
14 overall, whenever you reduce fraud losses. What's also
15 important is it's helping our merchants and it's helping our
16 card members. And our fraud loss rates are 50 percent less
17 than Visa and MasterCard.

18 Another area that's important for us is that we have
19 client relationship managers, and what their task is -- and
20 these are several hundred people. Their task is to work very
21 closely with merchants to understand what are their business
22 needs? What are their marketing needs? How can we help them
23 grow their business? And to have a dedicated group that will
24 really understand what the particular needs are of larger
25 merchants.

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1 And the last one would be the point that I made
2 starting off, is the opportunity to affiliate with our brand,
3 because our brand does stand for something, and it says to our
4 card members this is a place that you can feel comfortable
5 going to; Amex is behind it, is supporting it. And it's also
6 helpful to the merchant in attracting customers who are using
7 our products and the benefits we have provided them.

8 Q Saving with the benefits to merchants for another few
9 minutes, do you have a program called "Smart Offer"?

10 A Yes, we do.

11 Q Would you describe that to the Court, please?

12 A That is a very, very exciting program, where what we've
13 done is really harness the elements of the closed loop from a
14 digital and technology standpoint that benefits merchants and
15 card members alike. So let me just give you a few examples
16 and just talk briefly about how it works.

17 Q Uh-huh?

18 A So, for example, we did a program with Whole Foods. And
19 the way this program works is that you opt in, meaning you
20 register to come in; and based on your activities and your
21 spending categories, we actually can work with the merchant to
22 then personalize the offer. So if you think about this, the
23 amount of marketing dollars that you got to do in a
24 scattershot manner, we actually can personalize those
25 marketing messages. So that's the first key point.

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1 So in the case of Whole Foods, they wanted to build
2 traffic into their stores, and so -- but they wanted to target
3 it, so there are different options. You can say I'm going to
4 invite everyone to come in; that's going to be pretty costly.
5 Or I'm going to target the program. So we targeted the
6 program. And the way it worked is if you went to Whole Foods
7 three times, you got \$50. But here was the benefit of the
8 closed loop and the digital capabilities that we put in: One
9 is the card member didn't have to carry a coupon. It was
10 coupon less.

11 We could alert them to the offer on their mobile
12 phone but they could forget about it. But if they went to
13 Whole Foods, made their purchase, were there for three times,
14 nothing had to happen at the cash register. For the merchant,
15 they didn't need to train anyone. The cash register didn't
16 have to know. The cashier didn't have to know at all. So if
17 you think about the cost of training, the marketing expense
18 and being able to target that, all that happened was the card
19 was swiped.

20 The intelligence then went into our system because
21 we have to authorize the charge, right, and we have this
22 interdependency between the merchant and the card member. We
23 would send an alert, often to the card member. Maybe the card
24 member forgot. It then shows up on the statement. So this is
25 a real example of harnessing the value and the capabilities of

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1 the closed loop.

2 We've recently done an offer with Best Buy. You
3 spend \$250, you get \$25 back. Works the same way. We had an
4 offer with JCPenney; you spend \$50, you get \$10 back. So
5 what's critical for anyone who's engaged in marketing, the
6 more segmentation and targeting you can do, the more you can
7 be personal, you're then not only saving money, you're
8 creating a stronger relationship with that customer. That
9 customer is saying that's giving value. The benefit to the
10 merchant is that it's seamless. They don't have to change
11 their processes and procedures, their POS terminals, it just
12 happens. And other merchants benefit, so it's not just Whole
13 Foods, or Best Buy or JCPenney that gets the benefit, the
14 savings that the card member has incurred, they now have
15 increased discretionary money to spend in a responsible way.

16 Q Let me go back just for a moment to the consumer side.
17 In addition to rewards, you offer other benefits to your
18 cardholders' card members, correct?

19 A Yes.

20 Q So just very briefly for the Court, purchase protection,
21 travel protection, what are those?

22 A Purchase protection is that if you buy an item, its
23 stolen or damaged, up to 90 days from the time that you bought
24 that item, you can get it returned or repaired. So it enables
25 the customer to shop with a level of security and is viewed as

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1 a very, very positive benefit. Travel protection works very
2 much the same way.

3 Q Now, all of these benefits you've been describing, both
4 to the consumers and to the merchants, I take it that there
5 are costs associated with those for the company; is that fair?

6 A Absolutely.

7 Q Why do you spend all that money on these benefits? Why
8 not just process the transactions, collect your fee from the
9 merchants, and score it up as profits?

10 A You clearly need to focus on what I was saying; that we
11 have a differentiated business model that is an integrated
12 payments model. What is absolutely essential to make this
13 work is the chicken and the egg. I need to, in fact, have
14 customers who will use my card product at the merchant. I
15 need to generate spend for the merchant, because that helps
16 them grow their business. And if I'm doing that, I'm offering
17 the merchant more value and the card member is being welcomed
18 in that merchant.

19 So for us, this is a virtuous circle, that it is
20 absolutely essential that I'm meeting needs of this
21 interdependent group. They can't survive without each other,
22 in my model. I've got to take care of the card member, and
23 I've got to take care of the merchant for it to work. And
24 I've got to fund that, because I'm not running just a one-line
25 business, I'm running an integrated business with a

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1 differentiated business model. And as I said earlier, what's
2 driving our model is spend, responsible spend on the part of
3 our card members. So I got to meet the needs of my card
4 members and my merchants.

5 Q Now, there's been some talk here at the trial, some
6 testimony about the fact that your merchant fees, your
7 discount rate is typically set as a percentage of the amount
8 of the transaction at the merchant, correct?

9 A Yes.

10 Q And so some of the testimony's been, well, if there's
11 inflation and the merchant prices go up, then you collect more
12 money because you're getting a percentage of the total
13 transaction price. Do you understand that?

14 A Yes.

15 Q What happens to the costs that you're incurring -- for
16 rewards, fraud protection, travel protection, purchase
17 protection, targeted marketing for the merchants, all the
18 programs you talk about, if the inflation is it driving up the
19 merchant prices, what's happening to your costs?

20 A My costs are going up. That's the reality; my costs are
21 going up. And here's the other point: We're in an intensely
22 competitive environment, so clearly with inflation, my costs
23 go up. But I'm not operating in a vacuum, I'm operating in an
24 intensely competitive environment.

25 Q Could you just fund all of your rewards and your

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1 different programs by money you collect on the card member
2 side of the business?

3 A No, I've got an integrated model that -- what I can't do
4 is say -- I can take an action on one lever and it doesn't
5 matter to the other, it matters to the chicken or the egg,
6 what I do. And so the thought that I could implement a
7 strategy on one part of the business would destroy my ability
8 to continue to fund the investments needed to drive my
9 differentiated business model.

10 Q Based on all of your years in the company, Mr. Chenault,
11 is American Express a must-carry card?

12 A We are an a discretionary card. We do not have the
13 ubiquity and the size of Visa and MasterCard. You ask me how
14 many bank card issuers we have. We got 9. They got 10,000
15 plus. They got a billion cards. I got fewer than 55 million.
16 They got 9 million merchants. I got around 6. I mean, I am
17 dwarfed, so we are swimming in a sea of bank cards. So the
18 reality is that a merchant who wants to be in business and
19 offering plastic has zero choice but to accept Visa and
20 MasterCard. They are not in business.

21 A customer knows, if I'm going to use plastic, I got
22 to have MasterCard and Visa. What I have to do is I have to
23 persuade a merchant and persuade a customer that they should
24 carry our card. The way I do that is the way companies in
25 many industries operate, is I offer a differentiated product

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1 and service. And my job is to convince them, and to deliver
2 on this, better value; because they are not required to use
3 me, and that is a fundamental difference between MasterCard
4 and Visa and us, is any merchant will tell you, if I want to
5 be in business accepting plastic there is no choice but to
6 accept MasterCard or Visa. When it comes to us, there's a
7 choice, and that is in evidence by the fact that there are 3
8 million merchant locations out there that have said we're not
9 going to accept American Express.

10 Q Now, I'll come to this a bit later, but we've heard
11 testimony, including testimony this morning, that, yeah, there
12 may be 3- or 4 million location that's accept them and not
13 you, but they're all small and they don't really matter. Do
14 you agree with that?

15 A Absolutely not.

16 Q If you know, what -- approximately what percentage of
17 your customers are so-called small customers, that is, your
18 current merchant customers are so-called small merchants
19 today?

20 A 98 percent, so they're the same size. And the reality is
21 that 98 percent of the total of our merchants represent the
22 same size. So the reality is that those merchants have
23 clearly decided; they have freedom of choice, that they're not
24 going to accept us. And those merchants matter because
25 coverage matters. Perception of coverage is very important.

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1 Q We'll come back to that. When you say that the
2 98 percent of your merchants are the same size, same size as
3 the ones who don't accept you?

4 A Yes.

5 Q We'll come back to the merchants who don't accept you.
6 Let me ask you to look -- I hope I got this one in the book.
7 PX -- PXs are further down in the book than the DXs. PX2528,
8 I think it's the last document in your book.

9 A Yes.

10 MR. CHESLER: Your Honor, I believe this is already
11 in evidence and came in during Mr. Silverman's testimony.

12 Q What is this -- starting on the second page, titled "U.S.
13 Consumer Services Strategy and Product Update from
14 November 2013," what is this?

15 A It's an update on the Consumer Services Strategy and
16 Product Update, and I frequently get updates of this nature on
17 the business.

18 Q And if you look at the cover page, the e-mail on the
19 cover page, on the subject line toward the top it says "Final,
20 November 7th, Ken," deck. Are you the Ken that's referred to
21 there?

22 A I'm sorry. I was looking at the page after.

23 Q Yeah.

24 A So this is the e-mail to me.

25 Q Yes. Are you the Ken that's referred to --

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1 A Yes, I am.

2 Q Okay. Now, would you look at slide five, please, in this
3 deck. That's the page that has a Bate's number that -- stamp
4 number at the bottom that ends 203?

5 A Yes, I see it.

6 Q So this one is entitled "Chase," correct?

7 A Yes.

8 Q Chase's strategy. And the first bullet says "Chase is
9 copying our playbook, making inroads in penetrating the
10 affluent segment while growing overall spend share."

11 I take it Chase refers to the Chase Bank?

12 A Yes.

13 Q And they're an issuer?

14 A Correct.

15 Q On what networks does Chase issue cards?

16 A On MasterCard and Visa.

17 Q And what does it mean when you're told that they're
18 copying your playbook?

19 A What we have clearly seen, particularly after the U.S.
20 Government brought their case is --

21 Q Which case?

22 A This was the U.S. Government against Visa and MasterCard
23 in 2000 that I was actually asked to testify in by Joel Klein.
24 And one of the key points was that if we were allowed to issue
25 cards with banks, the Justice Department felt very strongly

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1 that even though we were a small player that we would be able
2 to dramatically change the competitive marketplace, and that
3 there would be more competition and innovation in the
4 marketplace. What has happened is that the bank cards have
5 become more competitive, but what also happened is that Visa
6 and MasterCard increased their interchange rates to, in fact,
7 enable the banks and encourage the banks to offer rewards and
8 premium products. So this model that you reference that we
9 use, they said we've got to replicate that model, and we need
10 to, in fact, replicate Amex's strategies so that we can gain a
11 position in the affluent segment.

12 MR. CHESLER: Your Honor, I think we have to switch
13 the system over.

14 THE COURT: Oh, sure.

15 MR. CHESLER: Thank you, your Honor.

16 Q Now, is Chase the only issuer that is copying your
17 playbook, Mr. Chenault?

18 A A number of issuers are copying our playbook. I think it
19 is very, very clear that our strategies and tactics are being
20 replicated by a number of players, not just the bank cards but
21 MasterCard and Visa.

22 Q And when it says they're making inroads and penetrating
23 the affluent segment while growing overall spend share, are
24 they growing spend share only among affluent segment or more
25 generally?

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1 A Both.

2 Q Now, were the bank issuers competing in this way, copying
3 your playbook, back in the '80s and '90s, before the
4 competition among issuers started?

5 A No, it was not in this way at all. In fact, exactly what
6 Joel Kline and the Justice Department said would happen, that
7 as a result of Amex being able to work with the banks, because
8 of the elimination of the exclusionary rule, that there would
9 be a tremendous level of procompetitive activity that would
10 benefit the consumer. And he made it very, very clear to me,
11 when he said we're not doing this for your company at all,
12 this has nothing to do with your company, we're doing this for
13 the market place and the consumer. And we believe, though,
14 that Amex can play a primary role in driving competition, even
15 as a small player against the dominant networks. And history
16 would serve him well here.

17 Q Let me ask you to turn to slide 17 in the same document,
18 please. That's at the page that ends 215.

19 A Yes.

20 Q So this one is entitled "Becoming a more inclusive
21 brand." It says we have an opportunity to unlock growth while
22 becoming a more inclusive blunt brand. Then there are
23 subheadings, financially underserved, mass affluent and
24 affluent. Do you see that?

25 A Yes.

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1 Q So what is this referring to with respect to the
2 financially underserved and the references -- one references,
3 for example, the Blue Bird at the bottom of that side of the
4 chart?

5 A I think what is very important -- and if you permit me,
6 it might be useful to go back in a little bit of history on
7 the company. One of the points that I emphasized is that we
8 have through our history been focused on a range of customers
9 segments. And if you think about the traveler's check
10 business, that was a business that I've emphasized in our
11 company that had no income requirement at all, and it played a
12 major role in building our brand. It was also a product that
13 was built on trust. Clearly you needed to have trust to carry
14 around a financial instrument that you thought people would
15 accept and would make good on.

16 And what's exciting about Blue Bird, which Blue Bird
17 is our co-branded product with Walmart and Serve is that there
18 are 70 million Americans who are unbanked.

19 Q What does that mean, unbanked?

20 A Meaning they do not have a checking account. And so we
21 believe that this is a group that is underserved by existing
22 institutions. If you have a -- if you don't have a checking
23 account, you pay several hundred dollars a year just to get
24 basic services. And what we said is -- we said we've got a
25 differentiated business model. We have got this closed loop,

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1 and we can offer a more attractive product financially. So we
2 dramatically reduced the fees on these reloadable prepaid
3 cards. But what we also did was we put this product also on a
4 digital mobile platform, so you can operate it like a physical
5 card. You can also operate it on your mobile phone. And
6 what's important about this is -- the term that we've coined
7 is, "It is expensive to be poor in this country."

8 So we're focused on financial inclusion, and we
9 believe very strongly that we have products and services --
10 and the Blue Bird product and the Serve product are products
11 that we are making substantial investments in to provide
12 capabilities and services. Now, what's important, just to
13 give you one example, is that you've got to pay an exorbitant
14 amount to cash a paycheck, and for that privilege of paying an
15 exorbitant amount, you just go to Bed-Stuy, you go up to the
16 Bronx and you can wait online for 45 minutes on a Friday. And
17 we've had our executives do that so they, in fact, could
18 understand the experience that these people were going through
19 and are going through.

20 Now, what we can do is not just meet some of their
21 basic financial needs of helping them pay their bills; they
22 can load their paycheck in, is they can now use this card on
23 the Internet. They were deprived because they could not
24 qualify for a credit card. Now, the option for us on the
25 other side was to say we're going to get into the subprime

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1 business and offer exorbitant interest rates to these
2 customers. Some of them wouldn't be able to qualify for that
3 card. And what's important here is this is totally consistent
4 with our spend-centric strategy, because we're giving
5 customers the right type of product for their needs. So this
6 customer's getting excellent customer service, purchase
7 protection that you mentioned. This customer's getting that
8 also because we value the needs.

9 Now, they're not getting all the services that we
10 would give a Centurion card member, because that economic
11 balance is not going to work, but we're making a fundamental
12 difference in their lives, as we are serving the mass affluent
13 and we're serving affluent customers. And I believe very
14 firmly that our company, American Express, must have products
15 and services that meet a range of customers' needs, and we're
16 very excited about what we're doing with serving people.

17 Q Generally speaking, how does the merchant fee -- when a
18 customer uses a Serve Card, for example, to do a transaction,
19 how does that fee compare to a fee on the traditional Amex
20 Cards?

21 A It's lower.

22 Q Substantially lower?

23 A Yes.

24 Q Would you look at slide 39, please. That's page 237, the
25 same document. The title says "Reinvigorating platinum value

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1 approach and tactics." Do you see that?

2 A Yes.

3 Q What does platinum value mean?

4 A Platinum value means the services and the benefits that
5 we have on the Platinum Card.

6 Q And why were you focusing on reinvigorated that value?

7 A Because what was happening, as we just talked about, is
8 that our strategies and tactics were being replicated. As a
9 result of the Visa MasterCard increasing their interchange
10 rates, the bankrupts were, in fact, increasing their funding
11 and investment in coming out with services to compete with us.
12 So whether it was reward programs or other types of benefits
13 and services, literally, you could go through our playbook, as
14 Josh indicated in his deck, and they were just taking the
15 pages out. But they were also funding those investments
16 largely from the increase in the interchange rates.

17 Q Now, in -- on the merchant side, we've talked about Chase
18 and other issuers taking your playbook or taking pages out of
19 your playbook on the card member side, the consumer side.
20 Have they been trying to duplicate features of your closed
21 loop on the merchant's side?

22 A Yes. The reality is that they have been active in
23 building up capabilities in trying to buy companies that can
24 perform some of the analysis or develop some of the
25 capabilities that will allow them to do more targeted

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1 marketing; that will allow them to provide certain services
2 that are very similar to what we do. From a client
3 relationship standpoint, I talked about we had a I group,
4 well, they all of a sudden created dedicated groups working
5 with merchants, so, again, exactly what Joel Klein and Justice
6 Department said would happen. There was more competition at
7 the -- with the networks, and there was more competition at
8 the bank card level, and consumers really got far more
9 benefits.

10 Q Before we go to another topic, let me just pick up on
11 your comment about Mr. Klein. You mentioned that you
12 testified as a government witness in *U.S. V. Visa*; is that
13 right?

14 A Yes, I did.

15 Q And were you prepared through your testimony before you
16 came to court to testify?

17 A Yes, I was.

18 Q And in the context of that preparation, did you have
19 direct face-to-face conversation, one or more, with then
20 Assistant Attorney General Klein?

21 A Several.

22 Q What, if anything, did he tell you about your role or the
23 significance of American Express testifying in that case?

24 A What he said to me is -- he said, Ken, it's very
25 important that you emphasize that American Express has a

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1 differentiated business model, because it's important to drive
2 more competition in the market place, and that is something
3 that I want you to do, is tell the story. Talk about your
4 model, that it is different, because what's critical is to
5 have increased competition and to have more innovation in the
6 marketplace. And he was particularly focused on making the
7 market more procompetitive, but it was also very focused
8 because he said I believe that there are going to be more
9 changes in technology, and so it's going to be critical that
10 that competition in the market be more open. And so he asked
11 me to really emphasize those points.

12 MR. CHESLER: Your Honor, I'm going to move to a
13 different topic. May we take five minutes?

14 THE COURT: Why don't we take a ten-minute break.

15 (Recess in proceedings)

16 THE COURT: Please be seated.

17 Let me just say it's a pleasure to have Mr. Chenault
18 in my courtroom today. He is a person of great stature in our
19 city and irrespective of the issues in this case, which are
20 being aggressively litigated, sir.

21 THE WITNESS: That's what I understand.

22 THE COURT: You know, the fact is that quite
23 independently of all that, it's a pleasure to have you here.

24 THE WITNESS: Thank you, your Honor. It's a
25 pleasure for me to be here.

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1 THE COURT: Well, I don't know about that.

2 THE WITNESS: I can think of other things I might
3 do, but --

4 THE COURT: There goes his veracity. Only kidding.
5 Go ahead.

6 Q Mr. Chenault, just one clean-up question on the subject
7 we were just talking about, you talked about the Blue Bird
8 product and the under-banked issue. There was another product
9 named on that chart called "Serve." I want you to explain to
10 the Court what Serve is, because you described your answer in
11 terms of Blue Bird.

12 A Yes. Serve is a reloadable prepaid card also that is
13 meeting the needs of the under-banked. And I think what's
14 important to understand, just as with charge cards and credit
15 cards, it's useful to have segmented products. And so the
16 Blue Bird product is a co-branded card with Walmart, obviously
17 is available to anyone who wants to acquire it. But what
18 we're also doing with Serve is that that is a product that --
19 we're working with a range of retailers in the U.S. right now,
20 although we hope to expand on an international basis, that
21 provide that product.

22 And it really is broadly targeted at the
23 under-banked and underserved. And we believe similar to Blue
24 Bird that it's meeting a real customer need and demand out
25 there, and it's doing it in a way that is attractive to the

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1 customer, from a pricing stand point, and also will generate
2 us appropriate economics, so we think it's going to be a
3 win-win.

4 Q Moving to another topic, do you, as part of your
5 responsibility, track and have people inform you of America
6 Express' share of spend in the United States and around the
7 world?

8 A Yes. As I said, spend, that's the engine for this
9 company.

10 Q Let me ask you to look at Defendants' Exhibit 7789.

11 A I have it.

12 Q And are you familiar -- you see at the bottom of this
13 chart, it refers to Nilson Report, are you familiar with the
14 Nilson Report?

15 A Yes.

16 Q Your experience, the people at American Express use them
17 to collect data about the industry?

18 A Yes. That's an industry report that we review
19 frequently.

20 Q You see that this chart is entitled "Amex's purchase
21 volume share for general purpose credit and charge cards."
22 And I just inform you these numbers do not include debit
23 volumes, just so you know that.

24 So I want you to focus on the left-hand side of this
25 chart, particularly the years 1990 to 1995. Do you see those?

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1 A Yes.

2 Q Now, according to this, the share of general purpose
3 credit charge card volume for American Express in those years
4 dropped by about a fifth of the whole business; is that
5 correct?

6 A Yes.

7 Q So from 24 percent and change to a little over 19 percent
8 during those 5 years?

9 A That's correct.

10 Q And, then, in the middle period, between those verdict
11 dotted lines, from about '95 to 2003 it looks like it was
12 essentially flat; is that consistent with your experience?

13 A Yes.

14 Q And then from 2003 on, basically to the last ten years or
15 so, up through 2012, it's been climbing, more or less, as
16 indicated there. Is that also consistent with your
17 experience?

18 A Yes.

19 Q You mentioned earlier that you have this GNS business,
20 the business where banks are issuing cards on the American
21 Express network, correct?

22 A Yes.

23 Q So as of today, about what percentage of America Express'
24 share spend is due to the GNS issued cards?

25 A Around 1 percent.

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1 Q One percentage point?

2 A Point.

3 Q So, for example, if the 2012 number looks like
4 26.4 percent, so if you deductible out the cards that are
5 issued from the nine banks, it would be about 25 percent
6 change?

7 A Yes.

8 Q Would you look at 7790 in your book? Should be the next
9 tab.

10 A Yes.

11 Q This says Amex's purchase volume share for general
12 purpose credit and charge debit and prepaid cards, correct?

13 A Yes.

14 Q Also based apparently on Nilson Reports?

15 A Yes.

16 Q Now, this one shows a sort of steadily declining share,
17 from about 24 percent in 1990, to less than 14 percent in
18 2011. Is that also consistent with your understanding, as you
19 looked at and tracked the company's shares over time?

20 A Yes, it is.

21 Q When did American Express first enter the payment card
22 business?

23 A In 1958.

24 Q And what was the company's first product, if you know?

25 A It was a charge card. It was actually made out of paper,

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1 and sort of had a white, sort of purple, coloring.

2 Q Was it targeted at some particular segment of the
3 population?

4 A It was really targeted at the business traveler, and so
5 it really had more of a business, travel and entertainment
6 orientation.

7 Q And did American Express, from around that time, have
8 nondiscrimination provisions in its agreements with accepting
9 merchants?

10 A Yes.

11 Q Now, if the early days, I know this is before you got to
12 the company, but I that I can take it you've made an effort to
13 become familiar with the history of the card business through
14 your 30-odd years with the company?

15 A Yes.

16 Q In the early days of the card business, did American
17 Express have any competitors who were issuing charge cards?

18 A Yes, we had two major competitors.

19 Q Who were there?

20 A Carte Blanche and Diners.

21 Q Were those cards also targeted at particular segments of
22 the business?

23 A They were targeted at the business traveler, and travel
24 and entertainment category.

25 Q Were they also charge cards, meaning you paid in full

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1 each month?

2 A They were charge cards, yes.

3 Q So none of the three company, at that time, was issuing
4 any credit cards; is that right?

5 A No.

6 Q That's correct?

7 A That's correct, yes.

8 Q Were Diners Club and Carte Blanche cards at the time
9 affiliated with banks?

10 A No, they were not.

11 Q So when, approximately, did Visa and MasterCard appear on
12 the scene?

13 A They came on the scene in the mid '60s.

14 Q And were they, from their initial introduction,
15 affiliated with the banks?

16 A They were really creatures of the banks. Reality is the
17 banks created and, if you will, owned Visa and MasterCard.

18 Q What happened to -- before the period picked up by these
19 charts, what happened to America Express' share of spend after
20 introduction of Visa and MasterCard?

21 A It went down. The reality is that Visa and MasterCard
22 spread like wildfire because they had access to all the banks,
23 channels and capabilities. So you open up a checking account,
24 you got a card. The reality is they were -- they were true
25 creatures of the banks.

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1 Q Did they issue charge cards when they came into the
2 business?

3 A No, they stated off issuing revolving credit cards and
4 that's continued.

5 Q So how did American Express respond to the competition of
6 Visa and MasterCard once they entered the business?

7 A I think, initially, they were still marketing their
8 product in the T&E category, but then what you started to see
9 is they started to go after some selected department stores,
10 and moved slowly in some areas, but they were still primarily
11 focused on the T&E category.

12 Q We heard about some department stores at which the judge
13 apparently doesn't shop, some stores earlier you think you
14 said yesterday?

15 THE COURT: Just one.

16 MR. CHESLER: One.

17 Q Do you remember any of the particular stores with which
18 American Express had these targeted card programs?

19 A Yes. And I may be off some years, very frankly, but
20 Neiman Marcus would be one, possibly Saks Fifth Avenue might
21 be another. And so these tended to be more high-end, affluent
22 retailers.

23 Q By the time you arrived at the company, 1981, how far had
24 this strategy of expanding beyond the T&E segment gone?

25 A They'd made some movement into other categories, but I

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1 wouldn't characterize it as substantial movement.

2 Q I think you testified earlier that when you came into the
3 company, you were director of strategic planning; is that
4 right?

5 A Yes.

6 Q What was the nature of your responsibilities in that job?

7 A It was a very, very, very small group. At the time,
8 actually the person who was running TRS at the time was Louis
9 Gerstner.

10 Q TRS stands for?

11 A Travel Related Services.

12 Q That was the part of the business that had the cards?

13 A Yes.

14 Q This is Louis Gerstner, who went on to be the CEO of IBM?

15 A Yes. And he formed a strategic planning group, and the
16 focus of the group was to really work on strategies. The way
17 he characterized it to me when he hired me was that he wanted
18 a few "catalytic agents of change," as he called it. So the
19 focus was to really drive and initiate different strategies
20 for the company.

21 Q Now, in particular, with respect to this fact that the
22 company was largely focused on the T&E segment and had made
23 some, but not a lot, of progress expanding out, did you have
24 any role, did you form any view, as part of the strategic
25 planning function, about what to do on that strategic front?

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1 A Yes.

2 Q What was that?

3 A One of my concerns early on was that the company needed
4 to focus on what I call "the spending needs of our customers,"
5 and that it was a mistake to just focus on one category of
6 spending, particularly with what was happening with Carte
7 Blanche and Diners. So you could see them becoming
8 increasingly irrelevant, and my view, and let me be very clear
9 here, it took several years for that view to gain some
10 acceptance. And, also, I would say, it was the view of
11 several others that the company needed to expand its
12 relevance. And the way I would characterize that is really
13 being more relevant in people's lives, and that was by meeting
14 more of their spending needs.

15 Q So, specifically, what was it about going beyond T&E that
16 would, in your view, make the product more relevant in
17 people's lives?

18 A Because if the focus is spend and the focus is point of
19 sale, you want your product being pulled out of the wallet
20 more often; you want to be able to meet the spending needs of
21 your customers. And to, in my view, artificially say I'll
22 only meet travel and entertainment spending needs, and, you
23 know what, I don't care what else you do, to me seemed to be a
24 very narrow way of thinking about the customer and the
25 customer needs.

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1 Q So what did the company do to pursue this expansion
2 strategy once it got traction within the company?

3 A There were several things that we did, and one back to
4 this chicken and egg focus, was, one, to say we need to expand
5 our acceptance outside of the travel and entertainment
6 category and actually try to understand where the spending
7 takes place so that we can meet the needs of our customers.
8 So we've got to expand outside of the travel and entertainment
9 category. The second was to develop some services, and
10 capabilities and products that would meet the needs of people
11 who wanted to use a card product outside of the travel and
12 entertainment category.

13 Q And during this period of expanding the base, was that
14 when the Membership Miles Program was born?

15 A Actually, right before, in 1987, we introduced the Optima
16 Card, which was a revolving credit card.

17 Q Was that the first one the company introduced?

18 A That was the first one that the company had offered. And
19 the focus there was, in keeping with -- in being more relevant
20 in the lives of our customers, is it was important that our
21 merchants see us; and if we're going into non-travel and
22 entertainment categories, it's pretty critical that they see
23 our brand and our considered being used.

24 In 1991, we developed Membership Miles, and what was
25 important about, again, the development of Membership Miles is

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1 that at the same time, because of the interdependency of card,
2 and merchant and chicken and egg, is we started to more
3 aggressively expand into everyday spending categories; because
4 if you're going to create what I talked about earlier with
5 rewards, this virtual currency, people need to be able to use
6 it.

7 Q And I think you said this before, but just so the record
8 is clear, Membership Miles is what ultimately became
9 Membership Rewards?

10 A Yes.

11 Q So the Optima Card comes along in the late '80s. The
12 Rewards Program begins in the early '90s. Was there during
13 this period of time a general expansion into merchants beyond
14 T&E?

15 A Yes, we began very aggressively expanding.

16 Q How about the card member base? Was that growing at the
17 same time?

18 A We were growing the card member base.

19 Q In the early '90s, what was roughly the division, at that
20 point, between charge volume at T&E merchants and charge
21 volume at non-T&E merchants?

22 A Roughly 70 percent coming out of T&E merchants, 30
23 percent everyday merchants.

24 Q What's that balance today, approximately?

25 A It's been, really, exactly reversed, so 30 percent coming

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1 out of T&E merchants, 70 percent coming out of everyday
2 merchants.

3 THE COURT: I'm sorry. Is that -- say, charge
4 volume, is that in terms of number of charges or in terms of
5 volume expenses?

6 THE WITNESS: That would be purchase volume.

7 THE COURT: Purchase volume. Dollars?

8 A Dollars, yes.

9 THE COURT: Oh, and I had a question. There's been
10 a lot of discussions about the different cards. There's also
11 a type of card that hasn't been discussed here. Maybe you can
12 tell me what that is. The American Express Black Card what's
13 that?

14 THE WITNESS: The Black Card --

15 THE COURT: Well, I've never actually seen one of
16 those.

17 THE WITNESS: Your Honor, if you would permit me,
18 this is mine, so I can't give it to you.

19 THE COURT: You can't give anything to me.

20 MR. CHESLER: There are lots of reasons why you
21 can't give it to him.

22 THE WITNESS: This is a Black Card. It's made out
23 of titanium. And what it has is a set of very specialized
24 services, so concierge type of services. So you can almost
25 think of it as your personal aide, I like to say. So it will

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1 help you with travel; it has a number of benefits on it, and
2 it is offered by invitation only to those customers within our
3 franchise who, in fact, spend at a certain level.

4 THE COURT: I see. I'm going to need a personal
5 aide, at some point. I'm not quite sure if that does it,
6 though.

7 THE WITNESS: Well, after the trial, and
8 everything's done --

9 THE COURT: I don't want to know.

10 THE WITNESS: Part of my job is to persuade.

11 THE COURT: All right. Sorry I asked. Let's move
12 on.

13 Q In the same time period as this strategy was being rolled
14 out, introduction of credit cards, introduction of Membership
15 Miles Program, was there also an aspect to the strategy that
16 involved technology?

17 A Yes, because back to the closed loop, which was very
18 important and was also one of the areas that Joel Klein wanted
19 me to focus on, was uniqueness of closed loop. The
20 information, the data, the analytics' capabilities were very
21 important. And what was essential was to continue to build on
22 and innovate the information and data that we got across our
23 integrated pavements model so we could continue to really
24 build on this differentiated business model through the use of
25 data and analytics.

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1 Q Was there a program launched in the '80s called Project
2 Genesis?

3 A Yes. It was it was launched in the '80s. It was a very
4 significant project that involved hundreds of people and had a
5 very substantial cost to it.

6 Q And what was Genesis?

7 A Genesis was a project to really harness the information
8 capabilities, the data from the closed loop, so that we could
9 offer more powerful capabilities to merchants and also market
10 in a more effective way to our card members, so really
11 harnessing the power of the closed loop and having the
12 information from the merchant and the card member, and being
13 able to leverage that capability.

14 Q And is that the beginning of the systems that have
15 allowed you to do things like the analytics you talked about
16 before and the targeted marketing programs you talked about
17 before?

18 A Absolutely.

19 Q Now did Diners Club and Carte Blanche pursue a similar
20 strategy to beyond expanding between T&E?

21 A No, they stayed in the travel and entertainment category.

22 Q Where are they today in the marketplace, in terms of the
23 hierarchy of the networks?

24 A They're irrelevant.

25 Q So let me turn -- as we move through the chronology a

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1 bit, let me ask you to look again at Defendants' Exhibit 7789,
2 please. It's that a share chart?

3 A Yes.

4 Q Living through that first five years that's shown on the
5 chart, '90 to '95, what was the reaction within the company to
6 that experience?

7 A A pretty terrifying experience. When you see the
8 precipitous decline in market share, it was frightening.

9 Q Did you at the time have a view as to what was causing
10 that decline?

11 A I think there were two fundamental things that were
12 happening, and I would call it the "double choke hold." As we
13 were trying to grow, the exclusionary rules that Visa and
14 MasterCard had put in, denying us the opportunity to work with
15 banks, essentially constricted our air supply. It's part of
16 the growth. And so it made it very difficult for us, because
17 we did not have access to one of the most important areas of
18 growth. At a time when the payments industry was exploding,
19 we were denied that opportunity.

20 The second choke hold was We Prefer Visa. Now, it's
21 one thing, from a competitive standpoint to say Amex is not
22 accepted, so that advertising campaign and they don't take
23 Amex; but what We Prefer did, in fact, went to the fundamental
24 strength and pillar that I talked about, of trust being part
25 of our brand and the cornerstone of our model of welcome

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1 acceptance. It said I don't care what American Express says,
2 merchants that accept American Express prefer Visa. So that
3 raised incredible doubt, because we had a position in the
4 marketplace that you can trust American Express, and welcome
5 acceptance was the cornerstone of that. So that went to the
6 core of our model.

7 Q Are you familiar in your -- in the course of your
8 responsibilities with something known as "spillover"?

9 A Yes.

10 Q What is spillover, as far as your understanding?

11 A Spillover is exactly what it means, that it's not
12 contained. So if a merchant does not accept us, or suppresses
13 us or says use another card, that spills over to other
14 merchants. And the card member then says, well, if it's not
15 accepted here, I'm not sure it's accepted at other places. So
16 it is incredibly damaging because it's not isolated and it's
17 not controllable, so the spillover can continue, and it is a
18 serious, serious problem when that happens.

19 Q Have you actually experienced it, seen it in the business
20 where you've been cut out of a particular areas or geographic
21 areas that there is, in fact, a spillover effect, more
22 generally, on spending volumes on cards?

23 A Absolutely. Here's the point: You can meet a
24 substantial percentage of someone's spending needs, and then
25 they go to a place and the card's not accepted; and they then

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1 question the entire value proposition. They question it
2 substantially when that place says, well, I accept Amex, and
3 then with We Prefer that raised substantial doubt on the part
4 of our customers, so it was pervasive impact.

5 Q With respect to the first of those choke holds you
6 mentioned, exclusionary rules, all these years later, in 2014,
7 has the company recovered from the effects of those rules?

8 A Absolutely not. I mean, the reality is that the
9 inability to work with banks is shown in the fact that we got
10 9. 9. Visa and MasterCard have 10,000. And the advantages
11 of being the creatures of the banks have remained. But,
12 frankly, that wasn't enough, because just the threat of the
13 lawsuit, the networks moved to the next level.

14 Q And what was that?

15 A And they came out with dedication agreements.

16 Q What are those?

17 A What those are, are the banks had to commit that a
18 substantial percentage of their cards would be on the network.
19 So while the case was going on, and even before, they were
20 preparing for the contingency, well, if we lose, first of all,
21 we got a major advantage. We got decades of an advantage.
22 But now with these dedication agreements we're going to lock
23 it in so that if we the Justice Department prevails, Amex will
24 have real difficulty signing up paying partners.

25 Q Has that been --

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1 THE COURT: Which case are you talking about now?
2 Because we've had three different --

3 MR. CHESLER: We were talking about the exclusionary
4 rules case, your Honor.

5 THE COURT: Exclusionary rules.

6 Q Has that strategy of the dedication agreements largely
7 worked for the banks?

8 A It clearly has worked for the banks.

9 Q Now, in addition to those two choke holds you talk about,
10 the exclusionary rules and the preference campaign, which
11 we'll come back to, were there issues, at the time, between
12 American Express and its agents over the level of your fees?

13 A Yes, we did have some issues.

14 Q And you remember something called the "Boston Fee Party"?

15 A Yes, I do.

16 Q What was that?

17 A The "Boston Fee Party," a number of restaurants actually
18 revolted against the company in the form of cancellation. We
19 actually had one restaurateur -- there was a photograph, I
20 remember, in the Boston Globe -- who put a knife through an
21 Amex Card, and they were, in fact, complaining about the fees.

22 Q And that was about 1990, was it?

23 A In that time frame, yes.

24 Q What, if anything, did American Express do in response?

25 A We met with the restaurateurs. We did several things.

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1 One, is we reduced our merchant rates. The second thing that
2 we recognized is, from a messaging standpoint, we had not
3 emphasized enough to the merchants the value that we brought.
4 So the value story of the incremental spend that we can
5 provide to them, that we needed to communicate that more
6 strongly. What we also recognized, back to the chicken and
7 the egg, is we needed to bring out more products that would
8 meet the needs of our card members and also increase demand
9 for merchants.

10 (Proceedings continued on the following page.)

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1 DIRECT EXAMINATION (continued)

2 BY MR. CHESLER:

3 Q Were there issues with other merchants other than the
4 restaurateurs in Boston at the time?

5 A Well, as I said earlier, back to spillover, it spread
6 into other areas and we had to deal with that and it also
7 raised issues in the minds of a number of cardmembers relative
8 to acceptance because when you have the articles that came out
9 about the issues relative to acceptance, that certainly caused
10 us problems.

11 Q Was one of the merchants that you had difficulty with in
12 that same time frame as Disney?

13 A Yes, we had difficulty with Disney.

14 Q What happened there?

15 A Disney basically threatened if we did not lower our
16 discount rate and if we -- even in any negotiation you have a
17 lot of back and forth, but one of the ways that Disney derives
18 substantial revenues is through sponsorships, and they
19 basically said, you know, if you don't do the following, we're
20 going to cancel you.

21 Now, you can imagine at that time, we're coming off
22 the Boston Fee Party. Disney, marquee name, and we were
23 terrified, and so we ended up doing a deal with Disney that,
24 frankly from an economic standpoint, was not a good deal to
25 do, but it was the right deal from an economic standpoint in

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1 the moderate to long-term because if we had lost Disney, the
2 impact would have been far greater than losing the charge
3 volume at Disney. It would have spilled over and spread to a
4 range of merchant categories.

5 THE COURT: Did you have a marketing agreement or a
6 co-brand card with Disney?

7 THE WITNESS: No, we did not, Your Honor. We did
8 have a marketing deal, and as I said, part of what Disney did,
9 it was not just a merchant acceptance deal, is they very much
10 focused on sponsorships, and so when you go to Disney, you'll
11 see all these different exhibits that are generally sponsored
12 by a company, whether that's Hertz or Avis or an airline, and
13 so we had -- we ended up agreeing to be a sponsor.

14 THE COURT: I see. And that continues with Disney?

15 THE WITNESS: We do not have the same relationship
16 with Disney. They still accept the card, but they actually
17 have, I believe still, a co-branded card with Chase.

18 THE COURT: I think you're right about that.

19 THE WITNESS: Yeah.

20 THE COURT: But you do have sponsorships with other
21 merchants and other events, with events.

22 THE WITNESS: We do.

23 THE COURT: Like the U.S. Open Tennis tournament,
24 for instance.

25 THE WITNESS: That's an example of a sponsorship.

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1 We, in fact with the U.S. Open, we've had a long-term
2 sponsorship. We are not the top-tier sponsor, but I think
3 we've put some very innovative programs in place where it
4 works very well for us and works very well for the U.S. Open
5 and works very well for our cardmembers.

6 BY MR. CHESLER:

7 Q There was a suggestion in testimony earlier today that if
8 you looked at a relationship between Amex and another
9 particular merchant in the way in which one of the economists
10 working on our side of the case looks at it, that it would be
11 an unprofitable relationship and the witness testified earlier
12 that therefore it couldn't possibly be the proper way to look
13 at it because it would be unprofitable.

14 Was the deal you made with Disney in order to avoid
15 being cancelled that you were just talking about, was that a
16 profitable or unprofitable deal if you looked at the deal that
17 was struck at the time?

18 A It was an unprofitable deal.

19 THE COURT: It was unprofitable at the time
20 financially, but it was the right business decision to make,
21 is what you said?

22 THE WITNESS: Yes, Your Honor.

23 BY MR. CHESLER:

24 Q Now, let me go back to the exclusionary rules case for a
25 moment.

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1 After that case ended, what happened to the
2 interchange rates that Visa and MasterCard were charging?

3 A The interchange rates increased.

4 Q What happened to American Express's discount rates in
5 that period, that is from the early 2000s up 'til today, the
6 last decade or so?

7 A They came down and they've been coming down.

8 Q Now, there's been some discussion at the trial that one
9 of the reasons that American Express rates have been coming
10 down is mix of merchants.

11 Has the mix of American Express's merchants, in
12 fact, changed over time?

13 A The mix of merchants has certainly changed from the early
14 '90s and mix has been an issue, but what we've also had to do
15 is make a number of concessions to merchants, and so it's not
16 just a mix issue. So mix certainly contributed to the
17 decline, but we also specifically have reduced discount rates
18 in different categories and to different merchants and we've
19 given bonus payments, and so that has contributed to the
20 decline.

21 Q And when the discount rate comes down, whether it's a
22 consequence of mix or the concessions that you've made in
23 merchant negotiations or both, what happens to American
24 Express's margin?

25 A Those margins are squeezed. Obviously as we are trying

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1 to satisfy both the chicken and the egg, we're have -- we have
2 to continue to increase and improve the value proposition and
3 the benefits to the cardmember and we have to do the same with
4 the merchant.

5 Q And as your margin declines as a result of a lowering
6 discount rate whether by mix or concessions or both, what
7 happens to your ability, sitting in your seat, to be able to
8 continue to fund those investments that you're talking about
9 on the consumer side of the business?

10 A It becomes more challenging to fund those investments,
11 but what's absolutely critical is that we're driving spend and
12 that we're getting welcome acceptance at the merchants. That
13 becomes, and is, as I said from the beginning, core.

14 Q Let me ask you to turn to, we've talked about the
15 exclusionary rules a bit, we've talked about the Boston Fee
16 Party and your problems with Disney and some merchant issues
17 you had at the time. I want to come back to this "We Prefer
18 Visa" issue that you mentioned before.

19 Would you look at Plaintiff's Exhibit 132, please,
20 PX 132. It's about two or three documents in the back of the
21 book.

22 A Yes. Does it start with "Visa USA Inc."?

23 Q Yes, that's it.

24 MR. CHESLER: Your Honor, this document's in
25 evidence.

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1 Q Now, Mr. Chenault, these are minutes of a Visa board of
2 directors meeting held in 1989. The document was produced by
3 Visa in this case. I'd like you to turn to page 3929 if you
4 look in the stamps at the bottom.

5 (The above-referred to exhibit was published.)

6 MR. CONRATH: Your Honor, I don't believe I've heard
7 a foundation for this document, this document with this
8 witness. It's a Visa document.

9 MR. CHESLER: If I can have a few moments, Your
10 Honor, I think I can demonstrate why it's relevant for this
11 witness to testify about it.

12 THE COURT: All right. Go ahead then.

13 BY MR. CHESLER:

14 Q So 3929 is a page from this Visa document entitled "Amex
15 Competitive Strategy Amex Success Cycle."

16 Do you see it, sir?

17 A Yes.

18 Q So it's a circle, right, connected by lines, arrows?

19 A Yes.

20 Q It says at the top: "Amex has real and perceived
21 advantages." And then down in the lower right it says: "Amex
22 charges merchants and consumers a premium." And then over on
23 the left it says: "Amex invests the premium in advertising,
24 systems, and services."

25 Correct?

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1 A Yes.

2 Q Now, is that a pretty accurate description of what your
3 business looked like in 1989 when this document was apparently
4 prepared?

5 A Yes.

6 Q If you look at 3930, the next page, you see that they've
7 put an X through the "Amex has real and perceived advantages"
8 and stated next to it: "Eliminate Amex's meaningful
9 advantages." And then down at the bottom there's an arrow
10 that says: "Breaking the success cycle will pressure their
11 merchant discount and thus weaken their financial engine and
12 encourage consumer preference for Visa and keep Amex as a
13 niche product."

14 Do you agree, Mr. Chenault, that if the success
15 cycle were broken and the ability of American Express to
16 provide meaningful advantages, as stated here, were to happen,
17 that that would in fact have the results that Visa predicted
18 or stated at the bottom of this page?

19 A That would destroy my business. That goes back to what I
20 discussed about our integrated differentiated model. This
21 goes directly at how we operate our business model and
22 directly how we fund our differentiated business model.

23 Q If Amex had been kept as a niche product, what, in your
24 view, would be the company's position as a competitor in the
25 marketplace today?

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1 A We'd be irrelevant.

2 Q Would you be any more relevant than Carte Blanche or
3 Diners?

4 A As I said, this would have destroyed our business model.
5 We would have gone the way of Carte Blanche and Diners.

6 Q More broadly, as the chief executive of the company, what
7 is your view of the impact that that would have on
8 competition, not on your company as per say, but on
9 competition more generally, were this strategy to eliminate
10 the meaningful advantages, to break the success cycle, were
11 that to succeed?

12 A It would be horrible. It reinforced the reasons why Joel
13 Klein asked me to testify and the Department of Justice
14 brought the lawsuit against MasterCard and Visa. Competition
15 would have been stifled. The only two players on the field
16 would be Visa and MasterCard who were the creatures of the
17 banks, and for consumers, the innovation that has taken place
18 post-2000 has been enormous and the consumer has benefitted
19 greatly. We would have been living in a totally different
20 world dominated by two players.

21 Q What about Discover?

22 A Discover has a three percent market share, and the
23 reality is Discover is in a situation where they have more
24 merchants and more cardholders than we do, and in my view,
25 frankly, they have a flawed model because they have not

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1 invested enough in differentiating their products and
2 services.

3 Q What impact did the "We Prefer" campaign have on your
4 business?

5 A It had a dramatic impact. You saw the precipitous
6 decline in market share and we were fighting for our survival.

7 Q Wasn't it just competition, I mean, kind of bare knuckles
8 competition?

9 A It was certainly not bare knuckles competition. As I
10 said, this double chokehold of the exclusionary rule, which
11 was totally anticompetitive, and as this chart demonstrates,
12 they were trying to break our success cycle and our ability to
13 fund our investments, and the way to do that, the way to do
14 that is what I said at the beginning of my testimony is the
15 most important attribute of our brand is trust and the
16 cornerstone of that trust is welcome acceptance.

17 MR. CONRATH: Your Honor, I think we're now getting
18 beyond what there was foundation for in talking about what
19 Visa was thinking and I object.

20 THE COURT: All right. Well, this document is in
21 evidence. What Visa was thinking is for Visa to say. How the
22 American Express Company perceived what they knew about it and
23 what they did about it is appropriate. So I'll allow it, but
24 anything about conjecture about how the Visa executives at the
25 time were posturing this in the marketplace or what steps they

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1 took is something for them to say and not for this witness.

2 Go ahead.

3 MR. CHESLER: Thank you, Your Honor.

4 MR. CONRATH: Thank you, Your Honor.

5 BY MR. CHESLER:

6 Q Would you look at page 3874 in the Visa document, please.
7 Do you have that? 3874 down in the lower right-hand corner of
8 the page.

9 A Yes.

10 Q If you look up in the third, sort of second full
11 paragraph on that page it says: "We believe the bank card
12 industry needs to recognize right now the threat the Project
13 Genesis," I assume it means "that Project Genesis means to
14 their long-term market share. We believe the bank card
15 industry needs to take action to counteract this threat
16 immediately. It is Visa's intention to take the lead in this
17 process."

18 You mentioned Project Genesis earlier and Genesis
19 was already underway by the time of this document in '89,
20 correct?

21 A That's correct.

22 Q And there had been public statements and reports about
23 it?

24 A Yes.

25 Q Had Genesis been killed for lack of funding, for example

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1 if your cycle of success had been broken, what, from your
2 perspective, would be the impact currently in American
3 Express's ability to provide competitive advantages to
4 merchants as well as consumers?

5 A Our model would be destroyed because the reality back to
6 the chicken and egg is we have to, in fact, have the ability
7 to, first and foremost, the moment of truth is welcome
8 acceptance. So the investments that we've talked about,
9 rewards, customer service, technology, are meaningless if in
10 fact our card cannot be used at the moment of truth, at point
11 of sale, and we cannot deliver on the promise of welcome
12 acceptance.

13 Q Let me ask you to look at another document, sir,
14 Defendant's Exhibit 7525.

15 Do you have that, sir?

16 A Yes.

17 Q So this is entitled "TRS Market Research Department
18 Executive Summary Report." And it says a little further down
19 "We Prefer Visa CM Impact Study."

20 CM stands for cardmember; is that right?

21 A Yes.

22 Q This is dated September 1997.

23 MR. CHESLER: I believe, Your Honor, that this was
24 also marked as Plaintiff's Exhibit 293. I don't think it's
25 been offered in evidence, but I just wanted the Court to note

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1 that a document that I think is the same as this document was
2 marked by both sides.

3 Q What is this document?

4 A This appears to be a executive summary report from our
5 Market Research Department that summarizes some of the impacts
6 of the "We Prefer Visa" campaign on cardmembers.

7 Q What did TRS stand for?

8 A Travel Related Services.

9 Q That was the part of the business that had the cards in
10 it?

11 A Yes.

12 Q And if you look at the third page of the document, it has
13 a number at the bottom that ends '383, there's a distribution
14 list on this page.

15 Do you see it?

16 A Yes.

17 Q And in the first group TRS executive, is that your name
18 the fourth one down, K. Chenault?

19 A Yes.

20 Q So were you, in fact, an executive in the TRS business at
21 that time?

22 A Yes.

23 Q And apparently a recipient of this document?

24 A Yes.

25 MR. CHESLER: Your Honor, I offer DX-7525.

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1 MR. CONRATH: No objection, Your Honor.

2 THE COURT: All right. DX-7525 is received in
3 evidence.

4 (Defense Exhibit 7525 was received in evidence.)

5 BY MR. CHESLER:

6 Q Would you look at the second page, the page opposite the
7 one we just looked at which has a '382 at the bottom.

8 Do you see that?

9 A Yes, I do.

10 Q And there's a heading in the middle of the page that says
11 "Reactions to the We Prefer Message?"

12 Do you have that section?

13 A Yes.

14 Q And I want you to go down to the second paragraph in that
15 section, the one that begins "when faced with."

16 A Yes.

17 Q It says: "When faced with this message at the points of
18 sale (when they had planned to use the card) insistence
19 remains high, but a fairly large percentage of spend is lost."

20 There's a bullet under that that says: "Over 70
21 percent of CMs would still use their American Express Card.
22 However, 21 percent of persons" - of personal, I think there's
23 an L missing - "Personal/Gold/Optima CMs feel they would
24 switch to another payment method."

25 A Yes.

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1 Q So from your vantage point at the time, it says 70
2 percent of your cardmembers would still use the card, but 21
3 percent of the Personal, Gold and Optima cardmembers feel they
4 would switch, how significant was that to American Express in
5 terms of its ability to be a viable competitor?

6 A That's enormous. If you have that type of perception
7 that builds and spreads, you're not going to have much of a
8 business left.

9 Q How does it spread if it's 21 percent? Why would it
10 become more over time?

11 A Because as a cardmember, if I have doubt whether I can
12 use the card, I keep it in my pocket, I don't pull it out, and
13 so the effect is major because part of what you have to have
14 on the part of a customer is they have to have a level of
15 confidence that they can use the product, and if they have
16 that doubt, that doubt builds, and the reality is that that is
17 a very alarming number because that's just not a number that
18 stays static, it builds, and it builds because of the doubt
19 that is created in the customer's mind.

20 Q If you look at the next passage at the bottom of that
21 page, it says: "Visa's preference messages appear to affect
22 our cardmembers perceptions of coverage. Nearly 60 percent of
23 cardmembers believe that these preference messages raise
24 doubts in their minds on whether Amex is accepted."

25 What is perception of coverage? Is that a metric

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1 that you use at American Express?

2 A Yes, and basically what it means is what do people
3 perceive where the card can be used, and as I said earlier,
4 that perception of coverage does not just go to a particular
5 category or merchant. It spreads. So if I've got problems
6 with coverage at a restaurant, that can spread over to retail.
7 So it's not isolated and it's really got to be focused on very
8 strongly.

9 Q So there's been some fair amount of testimony about words
10 in this case: preference, prefer, sponsor, official.

11 Based on all of your years of experience in the
12 company, sir, is there any real difference among those words?
13 What's all the reason for this attention on the word "prefer"
14 or "preference"?

15 A Here's what's critical. As I said earlier, the worst
16 thing that can happen to the American Express brand is
17 discrimination at the point of sale. When we're offering,
18 this is a fundamental cornerstone, welcome acceptance, that
19 preference, "we prefer" from a merchant that has agreed
20 contractually not to discriminate against us, when that
21 merchant then says use another card, pardon my language, but
22 what that says to the customer is that card's a piece of crap,
23 I don't like it, use something else. How do you think that
24 customer feels? And what that says is and that's what
25 discrimination is all about is disparagement and denigration

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1 and that's why it has a big difference. If I'm a sponsor,
2 everybody, you can be a sponsor. That does not denigrate.
3 That does not discriminate, but "we prefer," that
4 discriminates against our card.

5 Q Now, you had these, you said before, the
6 non-discrimination provisions had been in the merchant
7 agreements all the way back perhaps as early as the late '50s,
8 early '60s, right?

9 A Yes.

10 Q And there were provisions that said you can't express a
11 preference for somebody else's card well before this campaign
12 took place, right?

13 A Absolutely.

14 Q So what, if anything, did American Express do in response
15 to the preference campaign with respect to these provisions
16 that were already in the agreement and didn't prevent Visa
17 from engaging in this program to begin with?

18 A What we said to the merchants is you cannot discriminate
19 against American Express. That is in violation of the
20 contract and agreement that you signed and that Visa is
21 encouraging you to discriminate and violate the contract and
22 they're doing that obviously it was being done in favor of the
23 dominant networks MasterCard and Visa. So what was important
24 for us is to remind the merchants that what they were doing
25 was in violation of an agreement that they had entered into

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1 freely, because as I said, we are a discretionary product,
2 earlier in my testimony. They are under no obligation, they
3 don't need to operate their business accepting us, but they do
4 need Visa and MasterCard, and they made a contractual
5 commitment and they made a promise, and in my view of
6 business, when you promise something, you need to keep that
7 and that's how competition really can be generated. I'm fine
8 for merit-based competition, but violating an agreement that
9 you have willingly signed and be encouraged by someone to
10 discriminate cannot happen, and the impact of that, as I said
11 earlier, is it negates all the investments that we made for
12 cardmembers and merchants because we cannot provide welcome
13 acceptance.

14 THE COURT: Mr. Chesler, are you going to go into
15 how the cardmember insistence figures into this analysis and
16 discussion?

17 MR. CHESLER: Yes.

18 THE COURT: Because I think we've had testimony
19 about cardmember insistence and your measure of it and how
20 that works in your discussions with merchants and so forth.
21 So I was just wondering whether this was a good time, or are
22 you going to go into it later?

23 MR. CHESLER: We are going to cover it a little
24 later, if I may.

25 THE COURT: That's fine.

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1 MR. CHESLER: I plan to do that.

2 THE COURT: But I just point out that the issue of
3 cardmember insistence also is, it would seem, part of the
4 equation here, and so I'd like to hear about that.

5 MR. CHESLER: Yes, we fully intend to cover that
6 with Mr. Chenault.

7 THE COURT: Okay.

8 BY MR. CHESLER:

9 Q Let me ask you, sir, to turn to DX-7492.

10 Do you have that one, sir?

11 A Yes, I do.

12 Q It appears to be a memo from John Hayes, David House and
13 Tom Schick to Harvey Golub and Ken Chenault dated February 23,
14 1998.

15 Do you have that, sir?

16 A Yes, I do.

17 Q So you were a recipient of this memo?

18 A Yes, I was.

19 Q And if you recall, what was Mr. Hayes's job at the time?

20 A Chief marketing officer.

21 Q And Mr. House, what was he doing?

22 A He was president of Merchant Services. We may have
23 called it back then Establishment Services.

24 Q But it's the part of the business that dealt with the
25 merchants?

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1 A That manages the merchants, yes.

2 Q And how about Tom Schick, what was his job?

3 A Tom Schick is head of Public Affairs, communications.

4 Q And what was Mr. Golub's job at the time?

5 A Harvey was chairman and CEO.

6 Q And you were what?

7 A I believe I was president and chief operating officer at
8 that time.

9 MR. CHESLER: Your Honor, I offer 7492.

10 MR. CONRATH: No objection, Your Honor.

11 THE COURT: All right. DX-7492 is received in
12 evidence.

13 MR. CHESLER: Thank you, Your Honor.

14 (Defense Exhibit 7492 was received in evidence.)

15 BY MR. CHESLER:

16 Q If you look on the first page, the first bullet under
17 "Premises" says: "In the few markets in which Visa has
18 managed to launch a preference campaign we have experienced a
19 reduction in spending on our card products."

20 Then if you jump down two bullets it says: "The
21 likelihood that we can continue to successfully combat these
22 initiatives through a combination of moral suasion and
23 political contacts is diminishing. This is because of the
24 growing number of markets Visa appears to be targeting for
25 these campaigns and the increased financial incentives they

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1 are offering."

2 Do you have any memory of what kinds of financial
3 incentives they were offering?

4 A Well, they were paying merchants to advertise in the "We
5 Prefer" campaign.

6 Q Down at the bottom of this page it says: "These
7 developments are not only damaging in the short-term, but
8 could lead to a disciplined concentrated attempt by Visa to
9 surround us with a Visa-preferred world. In one scenario,
10 they could drop the "And they don't take American Express" tag
11 line which has lost its potency in the face of our vastly
12 expanded coverage and substitute Visa preference as their
13 signature."

14 Now, was it the sense of you and your colleagues at
15 the time that your ability to have diffused the "They don't
16 take American Express" campaign would not, in fact, be
17 successful with respect to the "We Prefer Visa" effort?

18 A We thought that the "We Prefer Visa" effort had gained
19 and was gaining substantial traction, and as I said before,
20 because it was advocating discrimination against the American
21 Express Card, it went right to welcome acceptance and would,
22 in fact, destroy our model.

23 Q Would you look at the next page. It says "Action Steps."
24 The first bullet says: "Our response should not involve
25 market/merchant preference campaigns of our own since, 1, we

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1 cannot afford to go they head to head in a bidding war with
2 Visa in a multiplicity of markets, and 2, we ought not to
3 abandon the moral high ground we now enjoy and which we can
4 continue to lever."

5 Was that consistent with your recollection of the
6 reaction to what your responses should be?

7 A Absolutely. I mean, we were competing with a monopoly
8 that was, in essence, as I said earlier, a utility and there
9 is no way financially we could compete with them in that way.
10 There was no way, given their ubiquity, the power that they
11 had that we could go tit for tat with them.

12 Q When you say that they're a utility, what does that mean?
13 What do you mean by that?

14 A What it means is they're must-have. There's no choice.
15 If you are a merchant and you want to accept plastic, you have
16 to accept MasterCard and Visa. Now, there are a few, we all
17 know there are a few who don't accept credit cards, but the
18 reality is the vast majority of merchants, you can really
19 count the ones who don't, anyone who accepts plastic knows
20 they have no choice, no choice but to accept MasterCard and
21 Visa.

22 MR. CHESLER: Your Honor, I'm going to move to
23 another topic. I just want to have a sense of what your plans
24 are for the day. How late do you plan to go today?

25 THE COURT: Unless the witness needs to leave at any

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1 given time, I would go until something close to six.

2 Is that acceptable?

3 THE WITNESS: That's acceptable to me, Your Honor.

4 THE COURT: All right. Should we take a break or
5 just keep going?

6 MR. CHESLER: Could we take five minutes, Your
7 Honor?

8 THE COURT: Let's take a five minute break.

9 MR. CHESLER: Thank you, very much, Your Honor.

10 (Recess taken.)

11 (In open court.)

12 BY MR. CHESLER:

13 Q Mr. Chenault, at the time of the preference campaign,
14 Visa and MasterCard were owned by the banks; is that right?

15 A Correct, yes.

16 Q What, if any, advantages did that give them in their
17 ability to or advantage in competing against you at the time?

18 A Well --

19 Q The fact that they were owned by the banks?

20 A Reality is you were dealing with a group that could act
21 almost as one, and it really was at the end of the day a
22 monopoly and a cartel and that's the way they operated, and so
23 what you did not see is Visa competing with MasterCard,
24 MasterCard competing with Visa. They could really, if you
25 will, gang up on a relatively small competitor and really

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1 devote their resources to their own business.

2 So certainly you had some competition amongst banks,
3 but the reality is when you look at the level of competition
4 that took place, the relative lack of innovation that was
5 going on in the marketplace, it was sort of like they were
6 just divvying up the world and, you know, we'll see how things
7 go, but we're really running things.

8 Q Do you see a lot of competition between Visa and
9 MasterCard today?

10 A The reality is I don't see a lot of competition between
11 Visa and MasterCard today, and that is incredible when you
12 think about the marketplace and the opportunities. It doesn't
13 seem that different to me from what we saw pre-2000. There
14 are obviously things they can't do, but you don't see Visa
15 taking out advertising criticizing MasterCard or MasterCard
16 criticizing Visa. I just haven't seen much competition
17 between them at all.

18 Q Are there any merchants that you're aware of that accept
19 one and not the other of Visa and MasterCard?

20 A No. That's why, as I said before, what's I think very
21 important to understand when we discuss the lingering effects
22 of the exclusionary rules, it really means what we're talking
23 about are the lingering and lasting effects of the
24 associations being creatures of the banks and the competition
25 really doesn't take place, and for a merchant, you don't find

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1 merchants that say 'well, I'm going to take Visa versus
2 MasterCard.' They know they are utilities, they're
3 interchangeable. 'If I'm going to be in the business, it's
4 going to be MasterCard and Visa.' You don't have a
5 cardmember, cardholder or a customer walk into a store and say
6 "Do you accept MasterCard? Do you accept Visa?" They don't
7 say that. So there's no, there's really no competition that's
8 going on.

9 So you see competition at the issuer level.
10 MasterCard and Visa may compete on some different deals and
11 from a dedication agreement standpoint there's some
12 competition, but if we look at what the essential elements are
13 here and the lingering effects from a merchant acceptance
14 standpoint, the merchant at the end of the day knows they got
15 to accept both, they're interchangeable.

16 Q So let me ask you to look at Defendant's Exhibit 319 in
17 the book. It's way up toward the front.

18 Do you have that, sir?

19 A Yes, I do.

20 Q It's entitled "Market Share. The Will to Win." It has
21 your name on it. Then it says: "Establishment Services
22 Worldwide Meeting Puerto Rico January 23, 1996."

23 What is this document, sir?

24 A This is a speech that I delivered to the Establishment
25 Services Group that we now call the Merchant Services Group,

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1 and it was a meeting of the worldwide organization, so it was
2 not just the U.S., this was a worldwide organization of
3 Establishment Services. That's the group responsible for
4 managing the merchant relationships.

5 Q And what position were you in in the company in January
6 of '96; do you recall?

7 A I believe I was vice-chairman of the company at the time.

8 Q Why did you give this speech?

9 A Because I was very concerned about the future of American
10 Express and I wanted to get the organization together, and at
11 this meeting, we not only had people from the Establishment
12 Services Group, but we also had people from the Consumer Card
13 Businesses, and I wanted to talk to them about the competitive
14 challenges that they faced, the structural challenges that we
15 faced as a company, and I wanted to talk to them about what we
16 needed to do.

17 Q And during this period of time, January '96, were you
18 facing the double chokehold that you referred to earlier?

19 A Yes.

20 MR. CHESLER: Your Honor, I offer Defendant's 319 in
21 evidence.

22 MR. CONRATH: No objection, Your Honor.

23 THE COURT: All right. Defendant's Exhibit 319 is
24 received in evidence.

25 (Defense Exhibit 319 was received in evidence.)

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1 MR. CHESLER: Thank you, Your Honor.

2 BY MR. CHESLER:

3 Q Would you turn to page 8, please, which has a stamp Bates
4 number ending '998?

5 A I see it.

6 Q At the top you say: "Now I'm going to show you the root
7 cause of my concern for our market share." Then at the bottom
8 the last bullet says: "I'll tell you what's not debatable.
9 We're behind and we're going to have to grow market share
10 substantially in terms of charge volume and share of
11 outstandings. This is the game we are in for the Card
12 business. We must become more relevant in the marketplace by
13 becoming more relevant in our customers lives. We can't
14 explain away our decline. We must reverse it."

15 What did you mean by becoming more relevant in your
16 customers lives and in the marketplace?

17 A I think as I said earlier, spend is the engine that
18 drives our business model and I thought it was very important
19 to emphasize to people that we needed to grow and we needed to
20 grow our share of spend and in doing that we would be more
21 relevant in the lives of our customers. We had to come out
22 with products that met their needs. We had to be innovative
23 in the services that we developed, but we could not accept a
24 decline in market share because I did not want us to go the
25 way of Diners Club and Carte Blanche.

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1 Q Did you at the time feel the need to further
2 differentiate your products?

3 A Absolutely. What was essential is to communicate to
4 people that to win in the marketplace we had to be more
5 innovative, we had to be more aggressive, and we needed to
6 invest to differentiate our business model even more.

7 Q Mr. Silverman testified the other day that in this
8 market, this two-sided network effect market, as he described
9 it, you either needed to be the biggest or the best.

10 Do you agree with that?

11 A I do.

12 Q You're not the biggest, right?

13 A We certainly are not.

14 Q So is the strategy to be the best to pursue this
15 differentiated strategy in all of the closed-loop advantages
16 and the customer programs that you've been talking about?

17 A Yes.

18 Q Why didn't you adopt a plan here like Discover apparently
19 adopted to be the low-cost provider, just lower your discount
20 rate so you're the cheapest option to the merchants?

21 A Because the reality is the chicken and the egg. We have
22 to fund the investments like rewards, like customer service,
23 like technology so we, in fact, can deliver sustainable value
24 to merchants and cardmembers, and I think that our
25 differentiated business model has proven successful

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1 particularly when you look at the situation of Discover, three
2 percent market share.

3 Q Has their share been sort of consistent over the years?

4 A Yes.

5 Q Why not fund your differentiated product just on the
6 consumer side of the business then in, you know, fees to your
7 cardmembers, interest payments on their outstanding balances
8 if they're revolving a balance?

9 A That goes against the integrated payments model that we
10 have constructed. The reality is that what you can't do in
11 business when you are running a differentiated business model
12 is simply say "I can make a change here" and it's not going to
13 have an effect, a damaging effect elsewhere. The reason why
14 we have this model is because it has allowed us to
15 differentiate ourselves in the marketplace, and we have to do
16 that by meeting the needs of cardmembers and merchants, and
17 that all comes together, all culminates at the point of
18 welcome acceptance because the engine that drives us is spend,
19 and that's what happens in a range of industries. That's what
20 differentiation is all about.

21 Q Do you have any examples, for example, from the computer
22 industry of how that differentiation strategy works?

23 A I'll give you one example, and I think a very good one,
24 with Apple. You know, people forget. I mean, they got an
25 incredible market cap now, but people forget where Apple was,

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1 and you remember when they came out with the Macintosh, people
2 were saying, "Steve Jobs, you're crazy. You can't offer this
3 price." And he said, "Wait a minute. I'm focused on the
4 functionality and design of the product. I want a
5 differentiated product in the marketplace." There were a
6 number of lower-cost competitors, but what he said, that is
7 frankly not very different from what I said, is he said, "I
8 want to be relevant in people's lives, I want to make a
9 difference in their lives, and I want to provide real value."

10 And so we're providing real value to cardmembers and
11 merchants, but what you can't do is then say to Apple 'hey,
12 wait a minute, why don't you just change this feature,'
13 because that's running a business for a year or two. I'm not
14 running a business for a day or a week or a month. I'm
15 running a business for moderate and long-term success. That's
16 what I've been very clear about with our people, very clear
17 about with our investors.

18 Q Let me ask you to turn to page 12 from your speech. It's
19 a page headed "Role of Establishment Services Worldwide in
20 Growing Market Share."

21 Do you have that page?

22 A Yes.

23 Q Going down to the second and third bullets you say:
24 "Their growing market share is not something that's done in a
25 vacuum. Responsibility doesn't fall solely to card marketing

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1 and advertising. In fact, I would argue that responsibility
2 for the most critical factors rests with the people in this
3 room." And you go on to say: "Because while the
4 competitiveness of our card value propositions is driven by
5 many factors, welcome acceptance is the core promise of
6 Payment Systems products. Without welcome acceptance, the
7 rest of our value proposition has only marginal value."

8 Is it fair to say, sir, that this concept of welcome
9 acceptance and the core promise wasn't something that was
10 created by the company for purposes of using it in this
11 litigation?

12 A I would have to be very clairvoyant to know that in 2000
13 the U.S. Government would ask me to testify about our
14 differentiated business model, that it would rest on the
15 criticality of welcome acceptance.

16 What this represents is what I started off in my
17 testimony, that trust over 164 years is what is most important
18 in our brand and welcome acceptance is the cornerstone, and I
19 think I made it very clear that whatever we did in other value
20 propositions, which were very, very important, made that very
21 clear, very important, were meaningless unless we could
22 deliver on welcome acceptance because that was the promise
23 that we made to our cardmembers, that is the commitment we
24 asked from our merchants and they agreed to, and that is the
25 way that we fund our differentiated business model, and I

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1 believed that way before 1996 and I believe it firmly now.

2 Q You remember we looked at that share chart and the market
3 share, if you don't include debit, started to climb slowly in
4 the, I think, 2003 period and by, I don't know, a year or so
5 ago it was essentially where you had been 25 years before,
6 correct?

7 A Yes.

8 Q You kind of went through a trough and over a 25-year
9 period basically got back to where you had been in 1990.

10 Is that fair?

11 A That is absolutely fair.

12 Q So why did it take so long, why was that climb back a
13 decade long?

14 A The reality is, as I said, we were dealing with the
15 double chokehold, just going through that trough, just
16 staunching the bleeding took an incredible effort on the part
17 of the entire company because you don't change these things
18 overnight, and so we had to deal with the double chokehold, we
19 had to invest substantial dollars in improving our value
20 propositions to merchants and cardmembers, we had to make
21 substantial investments in rewards, in customer service, in
22 technology, but we were able to get through that period, but
23 it took a tremendous amount of resilience, dedication, focus,
24 and commitment of our organization.

25 Q If you had not been able to stop the preference campaign,

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1 "We Prefer Visa," in your judgment, given your position in the
2 company and your experience, would you have come out of that
3 slump?

4 A We would not have come out. I think I made it very clear
5 in my speech and very clear in my testimony that welcome
6 acceptance is at the core of our business model and without
7 that we will not be able to continue to invest in a
8 differentiated business model and it will be over.

9 Q Let me ask you to look at Defendant's Exhibit 3096,
10 please. I think it's the next document in the book. This is
11 entitled "U.S. Membership Rewards Ken Chenault shirtsleeves
12 session June 13, 2006."

13 Do you have that document?

14 A Yes, I do.

15 Q What is a shirtsleeves session?

16 A These are sessions where sometimes I get updates on
17 business issues, sometimes we drill down on a subject,
18 sometimes we have a deck, sometimes - meaning a presentation -
19 sometimes it's more of a conversation on different issues. So
20 it's a way, in addition to the regular business meetings, that
21 I have that I can spend more time on particular issues.

22 Q Who proposes the subjects for your shirtsleeves meetings?
23 Is it you or members of the staff?

24 A It's mutual. Sometimes I will say here are some subjects
25 I would like to cover. Sometimes the management team said --

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1 says here are some subjects we would like to cover with you
2 and review.

3 MR. CHESLER: Your Honor, I offer Defendant's 3096.

4 MR. CONRATH: No objection, Your Honor.

5 THE COURT: All right. Defense Exhibit 3096 is
6 received in evidence.

7 (Defense Exhibit 3096 was received in evidence.)

8 BY MR. CHESLER:

9 Q Let me ask you to turn to slide 3, Mr. Chenault, third
10 page.

11 Do you have that?

12 A Yes.

13 Q It says "Executive Summary." That's the chart we're
14 looking at, right?

15 A Yes.

16 Q And the first bullet says: "Despite its centrality to
17 our results, we historically under-invested in maintaining
18 Membership Rewards market leadership. In the past two years,
19 however, we significantly ramped up investing in improving
20 Membership Rewards."

21 Now, is that consistent with your memory that
22 beginning in about 2004 there was a significant ramp-up in the
23 investments in the Rewards program?

24 A Yes.

25 Q Why in particular did it happen in that time frame?

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1 A Because what we saw is MasterCard and Visa, as I said
2 earlier, had raised their interchange rates encouraging the
3 banks to get more heavily involved in rewards and other
4 products for the premium segment, and the competition was
5 getting more intense because, as I said earlier, they were
6 basically replicating our playbook, and it was, in fact,
7 becoming almost an arms race in some areas and we had to ramp
8 up our investment.

9 Q We talked earlier about the way you would incur costs,
10 set up reserves, have to adjust the reserves when the
11 redemptions take place.

12 Do you recall that discussion?

13 A Yes.

14 Q Let me ask you to turn to the next slide, slide 4.

15 You see this one is entitled "U.S. Membership
16 Rewards Program Performance," right?

17 A Yes.

18 Q And you've got a column headed "2006F."

19 Is that a forecast?

20 A Yes.

21 Q And then the column to the right says "2005."

22 Are those actuals?

23 A Yes.

24 Q And then there's a comparison of the 2005 forecast with
25 the 2005 actuals, right?

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1 A Yes.

2 THE COURT: The numbers are redacted.

3 MR. CHESLER: Yes, and I'm not going to have the
4 witness recite the numbers in court, Your Honor.

5 THE COURT: Please remind the witness.

6 MR. CHESLER: Thank you, Your Honor.

7 Q There have been many, including myself, who have fallen
8 afoul of that rule. Let's see if we can get through this with
9 a perfect batting average and not mention the numbers.

10 There's one line on this chart "Ultimate Redemption
11 Rate."

12 Do you see that?

13 A Yes.

14 Q What does the ultimate redemption rate mean? What is
15 that a measurement of?

16 A That's our projection of the level of where we think the
17 points will be redeemed.

18 Q And without stating the numbers, is it right that the
19 forecast for 2006 showed an increase over the actual
20 redemption rate for 2005?

21 A Correct.

22 Q And when you increase the ultimate redemption rate, what
23 does that do to the reserves that you have to book for the
24 cost of your rewards program?

25 A You have to increase the reserves.

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1 Q So even though the -- even though the rewards haven't yet
2 actually been redeemed, so you haven't actually paid the
3 airline for that seat or you haven't paid the vendor for
4 whatever the product was that the customer bought with your
5 reward points, you have to up the reserve even when you just
6 change the estimate of the ultimate redemption rate?

7 A Yes.

8 Q And those costs, I take it, come off of your revenue to
9 get to your income, right?

10 A Yes.

11 Q Lowers your margin?

12 A Yes.

13 Q Would you look at slide 6, please. And again the numbers
14 have been redacted here. It's entitled "MR Expense 2006 to
15 2009 LRP."

16 What is LRP?

17 A Long range plan.

18 Q Without stating the numbers, what's the message of this
19 chart?

20 A The message is that we had a substantial increase over
21 that time period.

22 Q And again without stating the numbers, are the dollars
23 that appear at the top of each of those blue bars in billions
24 of dollars?

25 A Yes, they are.

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1 Q So those are billions of MR expense incurred or estimated
2 to be incurred in each of those years?

3 A Yes.

4 Q Did the actuals come out to be relatively consistent with
5 the estimates?

6 A Yes.

7 Q Look at slide 9, please. It's entitled "MR Key
8 Achievements January '05 to May '06." It's a pretty busy
9 chart. I don't want to take the time to go through it all,
10 but there's one that I would like to pause on for a moment.

11 At the bottom of the chart where it says "Partner
12 signings 2005," one of the merchants listed there is iTunes.

13 What do your Membership Rewards have to do with
14 iTunes?

15 A What I think is very important, it goes to the utility
16 and the value of the program and this notion that I talked
17 about of virtual currency, that you could redeem your points
18 to buy songs from iTunes, and I think we all understand how
19 popular iTunes are, and to have a redemption option that
20 someone did not have to build up high level of points and they
21 could redeem something that they considered of real value was
22 very important, and as I said earlier, is the benefit of that
23 is not just to Apple, but the benefit is to all merchants
24 because the customer knows if I'm using my card, I'm earning
25 points and I have a wide variety of options in the way that I

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1 can redeem those points. So it's making the program more
2 attractive and accessible for the cardmember in giving them a
3 wide range of redemption options, and that proved to be a
4 very, very good program, and as I said, the benefit went to
5 almost all merchants where someone was using our card.

6 THE COURT: Is there a Membership Rewards feature
7 for Bluebird?

8 THE WITNESS: There is not, Your Honor, at this
9 point. The economics would be more challenging. So we have
10 different features, but from a rewards standpoint, we do not
11 have Membership Rewards on Bluebird, but what we have done, as
12 I said earlier, is we have substantially reduced the fees, and
13 so the benefit to the customer is substantial and we've given
14 them also a very strong level of customer service and they do
15 have benefits like purchase protection.

16 THE COURT: I see.

17 MR. CHESLER: Your Honor, just one other page in
18 this document, then I think we're ready to conclude.

19 BY MR. CHESLER:

20 Q Would you turn to slide 39, please, Mr. Chenault. It's
21 entitled "Competitive Comparison Travel Redemptions."

22 Do you see that?

23 A Yes.

24 Q Now, listed across the top are a bunch of issuers.

25 Are those some selected competitors for travel

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1 redemptions?

2 A Yes.

3 Q Why in your shirtsleeves session do you get briefed on
4 this kind of information, what competitors are offering for
5 travel redemptions?

6 A I think it's very critical that we review competitive
7 comparisons pricing, value, benefits, services, features.
8 That is essential for us to stay very competitive in the
9 marketplace.

10 MR. CHESLER: Your Honor, I'm going to move to a
11 somewhat different subject. Is this a good time?

12 THE COURT: Yes, I think this is a good time to
13 adjourn for the evening.

14 Let me ask about how much more time do you think
15 you're going to use for the direct for Mr. Chenault?

16 MR. CHESLER: I think, Your Honor, perhaps around
17 the midmorning break or so, maybe a little over that, but
18 around the eleven o'clock break or so.

19 THE COURT: All right. And in terms of the
20 Government on cross-examination?

21 MR. CONRATH: I would estimate about three hours,
22 Your Honor.

23 THE COURT: And that would mean that you'll be able
24 to call your next witness tomorrow afternoon.

25 MR. CHESLER: Yes, Your Honor. We have another

1 witness and we've informed the Government of who that is.

2 THE COURT: Okay. That's fine. And I also wanted
3 you to provide this information for the witness so he would
4 know about when he'd be released from his indenture here.

5 MR. CHESLER: It sounds like if we're doing our math
6 right, probably around three p.m. or so.

7 THE COURT: That sounds about right to me.

8 MR. CHESLER: We haven't been great in our
9 estimates, but we're getting there.

10 THE COURT: All right. That's fine. I just wanted
11 to get a general idea.

12 MR. CHESLER: Thank you.

13 THE COURT: All right. We'll see you tomorrow
14 morning, sir, 9:00.

15 THE WITNESS: Thank you, very much, Your Honor.

16 MR. CHESLER: Thank you, Your Honor.

17 (Time noted: 6:03 p.m.)

18 (Whereupon, the proceedings were adjourned to
19 July 31, 2014, at 9:00 a.m.)
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